AMERICANS for TAX REFORM
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ATR's Free Market Banking Reforms for 2025 and Beyond

With Election Day about four months away, pundits and policymakers are already deliberating the types of policy proposals they wish to pursue going into next year. On the banking front, a litany of regulatory and legislative reforms is needed in the wake of the current administration's unjust regulatory agenda. These reforms would rein in the administrative state while simultaneously enabling a free market banking sector that elevates the quality of service to consumers, borrowers, shareholders, and businesses of all sizes.

In certain cases, Congress should codify reforms in federal statute first to prevent the executive branch from abusing its authority. One of the problems with contemporary banking regulation is that the executive branch has taken on the role of the administrative state—with unelected bureaucrats acting as a fourth branch of government. Elected officials in Congress make the laws of the land, not the executive branch.

The recent promulgation of the Basel III Endgame proposal is a prime example of the administrative state's overreach. The bank capital rule, which is the U.S. regulatory implementation of Basel III Endgame, directly circumvents Congress's authority to write laws that govern U.S. banks.

Basel III was not a creation of Congress, but the brainchild of the Basel Committee on Banking Supervision—an intergovernmental arm of the Bank for International Settlements composed of regulators from around the world. The Basel Committee and its regulatory frameworks have no legal authority in the U.S. However, U.S. regulators have been happy to indulge and, in some cases, apply even stricter standards without providing the necessary empirical evidence to justify such onerous regulations.

The executive branch needs to remain within its remit. Too often, regulatory agencies, such as the Federal Reserve (Fed), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Consumer Financial Protection Bureau (CFPB) propose congressionally unauthorized rulemakings (the bank capital rule being one of them). Fortunately, the affirmation of the major questions doctrine and the repudiation of the Chevron doctrine both further reassert the separation of powers among the three branches of government. Federal regulators will no longer be able to unilaterally interpret ambiguous statutes and promulgate regulations that vaguely align with statutory authority. The executive branch will not be able to issue economically significant rules unless explicitly authorized by Congress. If a rule is disputed, the judiciary, not the agency, will be the sole entity assigned to interpreting its alignment with Congress's intent. This rightly reaffirms the constitutional powers and limitations afforded to each branch of the federal government. The new case law will help reduce the administrative state's power and strengthen the banking sector and financial markets in the U.S. for years to come.

Ideally, a new administration would first pause any pending rules, guidance, supervisory letters, etc., to reassess and propose new light touch regulation that is firmly based on statutory authorizations. Below is a comprehensive list of banking reforms that a new administration and Congress should consider.

LIST OF REFORMS:

- **Rescind mergers and acquisitions (M&A) proposals from the Fed, FDIC, and OCC.**
    - The FDIC and OCC recently issued new M&A guidance that arbitrarily slows down the process for approving M&A. They specifically allow activists to use the Community Reinvestment Act (CRA) to throw roadblocks in front of a merger without any evidence to prove a merger would hinder investment in certain communities.
    - Realign Fed, FDIC, and OCC merger protocols so they focus on only material deficiencies and not every aspect of a bank's business. The guidance should also not be designed to slow walk mergers on baseless claims.
- **Require M&A applications to be approved within 120 days of filing.**
    - Issue regulations to grant approval of an application within 120 days if no decision has been made.
    - Enact Reps. Andy Barr (R-Ky.) and Scott Fitzgerald's (R-Wis.) bill, giving the Fed an even tighter deadline of 90 days. The purpose is to ensure regulators do not let mergers die due to bureaucratic inaction.
        - The bill codifies strict deadlines for approving a merger application. This prevents regulators from arbitrarily slow walking the M&A process while leaving banks in limbo.
- **Stop conditional approval of mergers based on future activities.**

- A classic scenario exemplifying excessive government intervention is when regulators condition mergers based on a bank's commitment to halt stock buybacks or dividends. A regulator should know as it reviews an application if a bank is already well-capitalized, and if the combined entity will be well-capitalized. Telling a bank what it should do with its equity not only undermines the bank's shareholders, but also treats the bank as a quasi-governmental entity.

- **End weaponization of the Community Reinvestment Act.**
  - Congress should prohibit activists from abusing the CRA to stop bank mergers. Congress must reassert the consumer welfare standard in legislation and wherever necessary when examining bank mergers.
- **Remove the regulators' stranglehold on arbitrary bank examination metrics.**
  - Remove the "Management" factor for the capital adequacy, asset quality, management, earnings, liquidity, and sensitivity (CAMELS) rating system. The "Management" factor is a method for bank examiners to coerce banks into adopting ESG/DEI factors. This element should be eliminated because it focuses on ancillary and nebulous non-financial factors.
  - Ensure bank examiners solely consider "material financial risks" and not all bank activities. Gratuitous examination is expensive and time-consuming. Examiners should not be allowed to waste time looking at governance but prioritize capital adequacy, credit risk, and liquidity risk.
  - "Matters requiring attention" (MRAs) and "matters requiring immediate attention" (MRIAs) should only focus on material financial risks.
- **Compel regulators to strictly follow legal precedent when enforcing cease and desist orders for unsafe and unsound practices.**
  - One court ruling out of the D.C. Circuit Court of Appeals found that unsafe and unsound practices only apply to activities "that threaten the financial integrity of the" bank. The unsafe practice must "must pose an abnormal risk to the financial stability of the banking institution." Anything else is negligible, and in the eyes of the law goes beyond what is considered unsafe or unsound for purposes of filing an enforcement action.
- **Clarify that bank examiners are not authorized to scrutinize banks for compliance with federal consumer protection laws.**
  - This is already mandated in the Dodd-Frank Act but has yet to be implemented.

    - 12 U.S.C. § 5515(e)(4)(G) prohibits the Fed, FDIC, OCC, and National Credit Union Administration (NCUA) from examining banks and credit unions with more than $10 billion in assets for compliance with federal consumer protection laws. The provision states that this authority rests with the CFPB. Policymakers should clarify that this enforcement authority may not be duplicated by multiple agencies.
- **Enact general transparency with regard to banking rules and requirements.**
    - Require regulators to determine how a rule will affect consumer welfare, explain the statutory authority, and provide a substantive cost-benefit analysis along with a quantitative impact study.
    - Compel more transparency around how the Fed conducts stress tests—such as releasing data and models. Stress tests should also be subjected to a notice and comment process that allows for stakeholder feedback.
- **Prohibit regulators from using guidance documents to enforce new rules.**
    - Regulators have historically used guidance documents to avoid the notice and comment process.
        - For example, the Securities and Exchange Commission's (SEC) Staff Accounting Bulletin 121, and the interagency guidance on principles for incorporating climate-related risks into bank risk management practices. These documents never went through the formal notice and comment process for a rulemaking. Regardless, the documents carry a significant amount of weight and will ultimately direct bank activities.
    - In 2017, the Government Accountability Office (GAO) found interagency guidance on leveraged lending should have been issued as a rule under the Congressional Review Act. The Fed, FDIC, and OCC circumvented the notice and comment rulemaking process to quickly place limits on certain types of bank loans. This is not only micromanagement, but an abuse of law and a quintessential example of the administrative state's unbridled power over private companies. **A new administration could rescind this interagency guidance.**
- **Repeal Method 2 surcharge for global systemically important banks (GSIBs).**
    - The Method 2 surcharge penalizes GSIBs for reliance on short-term wholesale funding (e.g., time deposits or other funding with a maturity of less

than one year). Method 2 is a gratuitous and arbitrary penalty. Banks' reliance on short-term wholesale funding has "remained low."

- **Rescind rule requiring midsized banks to issue long-term debt (LTD).**
    - A new government-imposed "substantial layer of liabilities" ahead of uninsured deposits would further subject banks to more regulatory oversight and scrutiny.
    - Imposing LTD on banks is also akin to additional deposit insurance because it introduces a new moral hazard for uninsured depositors.
    - It also forces banks to add more leverage and thus impose more instability and risk.
- **Enact legislation that codifies prohibitions on "Operation Choke Point" activities.**
    - Regulators such as the Fed, FDIC, and OCC would be prohibited from forcing banks to shut down accounts purely based on reputational risk. During the Obama administration, the FDIC and OCC pressured banks to eliminate relationships with firms it deemed a "reputational risk." This "choke point," so to speak, can only be permanently terminated by codifying restrictions in federal statute. Rep. Blaine Luetkemeyer (R-Mo.) has led this effort in the House, while Sen. Ted Cruz (R-Texas) has led the effort in the Senate.
- **Repeal the Durbin Amendment as enacted in the Dodd-Frank Act.**
    - The Durbin Amendment sets a government-mandated price control on debit card interchange fees. It is the precursor to the Credit Card Competition Act. This law is why debit card rewards programs have largely become nonexistent.
    - Capping interchange fee revenue results in fewer rewards or cash back because banks and credit unions finance consumer rewards via interchange fee revenue. The revenue is also used to fund privacy protections, and for credit cards, allocate credit.
- **Prohibit the Fed from implementing changes to the debit card interchange fee cap without Congressional reports, testimony, and publication of quantitative analysis.**
    - The Fed should freeze implementation of the Regulation II amendments.
    - Congress can pass Rep. Luetkemeyer and Sen. Ted Budd's (R-N.C.) bill to study the Regulation II rule and its economic effect on certain communities prior to finalizing it.

- **Eliminate the cap on non-brokered reciprocal deposits.**
  - In 2018, Congress passed legislation that determined reciprocal deposits would no longer count as "brokered deposits" as long as non-brokered reciprocal deposits made up less than $5 billion or 20 percent of a bank's liabilities, whichever is less. This cap should be eliminated altogether. Reciprocal deposits should not be considered brokered since they are fundamentally different. Reciprocal deposits are distributed to different banks to keep deposits below the $250,000 insurance threshold. This is a free market solution to insuring deposits without worsening moral hazard. Individuals and small businesses can benefit from this reform.
  - Policymakers should take measures to prevent non-brokered reciprocal deposits from falling under the definition of "short-term wholesale funding" for the Method 2 GSIB score.
  - Eliminating the cap should be done in lieu of increasing the deposit insurance limit.
- **Realign the Collins Amendment with Congress's original intent.**
  - The Collins Amendment, like the Durbin Amendment, was enacted as a part of the Dodd-Frank Act. This provision set minimum requirements for the amount of capital a bank must hold as a percentage of the risk-weighted assets and average total assets they are exposed to. The Collins Amendment also prohibited trust preferred securities from counting as Tier 1 capital (e.g., retained earnings and common stock).
  - The Collins amendment should not include buffer calculations like the Stress Capital Buffer, Capital Conservation Buffer, and the GSIB surcharge. It should only apply to risk-based capital requirements and the leverage capital requirements, as mentioned above. **Regulators have wrongly applied the buffer requirements to the Collins floor, which has raised capital requirements far higher than was initially envisioned by Congress. Between the nullification of Chevron deference and the ruling in *Corner Post*, perhaps now it will be easier to rectify this gross, yet intentional, misinterpretation of Section 171 of the Dodd-Frank Act.**
- **End the FedNow project.**
  - This payment network, which is run by the Fed, crowds out private alternative payment rails. It has also been lauded by Democrats in the U.S. House.

- **Eliminate duplicative consumer finance examination among regulators.**
    - The Fed, FDIC, and OCC should not duplicate consumer finance examinations that the CFPB conducts.
- **Force regulators to report to Congress on their interactions with the Basel Committee on Banking Supervision, International Monetary Fund, Financial Stability Board, and Network for Greening the Financial System.**
    - Rep. Barry Loudermilk (R-Ga.) has proposed a bill that would increase transparency and hold federal agencies accountable for this reason.
    - Rep. Roger Williams (R-Texas) also has excellent legislation requiring the Fed to submit additional information in its annual report to Congress. This information includes any expenditures used to coordination efforts with the Basel Committee on Banking Supervision or other intergovernmental groups such as the Network for Greening the Financial System.
    - Policymakers should impose a formal notice and comment process on any proposals being considered by U.S. regulators originating from an intergovernmental organization.
- **Enact legislation to prohibit regulators from requiring government models.**
    - The bank capital rule applies a standardized framework that prohibits banks from using their own models to determine certain risk exposures. Regulators should not be allowed to impose such arbitrary mandates.
- **Eliminate reliance on Fannie Mae and Freddie Mac to backstop the U.S. mortgage market.**
    - Fannie Mae and Freddie Mac have remained in conservatorship for over fifteen years. As long as they remain in conservatorship, U.S. taxpayers are backstopping risks associated with guaranteeing mortgages.
    - Bank regulations, such as bank capital requirements, force banks to hold a certain amount of equity as a fraction of exposure to certain assets, such as mortgages or mortgage-backed securities. This has made the U.S. housing market more reliant on Fannie and Freddie to guarantee mortgages in the event of defaults on mortgage payments. It has also contributed to rising housing prices because it subsidizes demand, which is outpacing housing supply.
- **Eliminate the provision of the Dodd-Frank Act permitting CFPB enforcement authority over federal consumer financial laws.**
    - The CFPB has consistently issued rulemakings beyond its remit. The CFPB is eager to control how not just banks, but how credit unions and nonbank

financial companies run their businesses. This is evident because the CFPB has issued rules to manipulate certain fees such as overdraft fees, nonsufficient funds fees (NSF), credit card late fees, and mortgage closing costs.
    - 12 U.S.C. § 5515(c)(1) enables the CFPB to enforce federal consumer financial laws over banks and credit unions.
- **Make clarifications to unfair, deceptive, or abusive acts or practices (UDAAP) principles.**
    - Making UDAAP consistent with the CFPB's 2020 policy statement would also be a good step. This ensures that the CFPB enforcement authority is not weaponized.
    - Rep. Barr has legislation to clarify UDAAP.
- **Subject CFPB to congressional appropriations.**
    - Rep. Barr has legislation to subject the CFPB to the congressional appropriations process and enact broader CFPB reforms.
- **Enable more transparency with the Fed and FDIC's decisions on bank's living wills.**
    - In 2016, the GAO pointed out how the Fed and FDIC have done a poor job explaining how they make certain determinations when banks file their annual resolution plans. These plans are required by the Dodd-Frank Act in the event a bank fails. While the reports are required to be submitted annually, regulators are held to a double standard—having no deadline themselves to provide feedback.
- **Amend 31 U.S.C. § 5318 and implement regulations to prevent the federal government from prohibiting banks from revealing suspicious activity reports (SARs).**
    - The Financial Crimes Enforcement Network (FinCEN) prohibits banks from acknowledging SARs. In many cases, this creates a disconnect between bank account owners and the banks that shut down or freeze their accounts.
- **Ensure that the Fed, FDIC, OCC, and CFPB do not duplicate FinCEN and the Office of Foreign Assets Control's (OFAC) statutory obligations.**
    - Bank examiners already abuse their power over banks by focusing too much on immaterial, nonfinancial factors. This is what ultimately contributed to Silicon Valley Bank's (SVB) collapse. The Fed's failure to prevent the SVB collapse in the face of numerous red flags is well documented. Examiners should not duplicate efforts to impose sanctions and anti-money laundering frameworks—they must remain within their statutory authority.