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# The Financial Banking Institute Act and the Financial CHOICE Act: The Wrong Choice for the American Economy

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## INTRODUCTION

Following the financial crisis of 2007-2008, public trust in financial institutions plummeted to historic lows[1] and has yet to fully recover.[2] In the years leading up to the financial crisis of 2007-2008 many financial institutions were allowed a virtual field day, allowing for "poor monetary policy, deregulation, bad regulation, innovation run amok, and

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[1] Frank Newport, *Americans' Confidence in Institutions Edges Up*, GALLUP NEWS (June 26, 2017), http://news.gallup.com/poll/212840/americans-confidence-institutions-edges.aspx (finding that American confidence in American "big businesses" hit a low of 16 percent in 2009 and American trust in banks declined ten percent from 2008 to 2009 from 32 to 22 percent—the lowest reported percentage in over 40 years).

[2] Justin McCarthy, *Americans' Confidence in Banks Still Languishing Below 30%*, GALLUP NEWS (June 16, 2016), http://news.gallup.com/poll/192719/americans-confidence-banks-languishing-below.aspx (noting that "[t]he current percentage of adults who say they have confidence in banks is just half of what it was in 2004").

greed" to gain a stranglehold on the American economy.[3] While financial institutions cannot exclusively be blamed for the crisis, they must be held accountable in order to prevent subsequent financial crises.[4]

In response to the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[5] Dodd-Frank was created to "improve systemic stability, improve policy options for coping with failing financial firms, increase transparency throughout financial markets, and protect consumers and investors."[6] The Dodd-Frank Act implemented a number of provisions designed to further transparency, accountability, and stability in the American financial sector.[7] One of these reforms was the creation of the Orderly Liquidation Authority, designed to quickly and efficiently liquidate failing large financial firms.[8] The Dodd-Frank Act also established the Consumer Financial Protection Bureau (the "CFPB") which allows for enhanced prudential regulation and heightened standards of accountability and stability.[9] Furthermore, the Act also created what is known as the Volcker Rule, a ban on proprietary trading—trading that is intended to benefit the bank, not the bank's customers.[10] In addition to these reforms, Dodd-Frank ushered in a culture

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[3] Adam J. Levitin, *The Crisis Without a Face: Emerging Narratives of the Financial Crisis*, 63 U. MIAMI. L. REV. 999, 1000 (2009).
[4] Anton R. Valukas, *White-Collar Crime and Economic Recession*, 2010 U. CHI. LEGAL F. 1, 21 (2010).
[5] Wall Street Reform and Consumer Protection Act, 12 U.S.C. ch. 53 (2012).
[6] BAIRD WEBEL, CONG. RES. SERV., R41350, THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: ISSUES AND SUMMARY 3 (2010).
[7] See *id*.
[8] 12 U.S.C.A, § 5384 (2015).
[9] 12 U.S.C. § 5491 (2012).
[10] 12 U.S.C.A. § 1851 (2018).

change, eschewing the toxic and greed fueled culture in favor of a more diverse and transparent culture.

In 2017, Congress made significant moves to abrogate much of the Dodd-Frank Act.[11] On April 5, 2017, the House of Representatives passed the Financial Institution Bankruptcy Act of 2017 ("FIBA").[12] FIBA would invalidate many of the provisions of Dodd-Frank which govern the liquidation of failing major financial institutions and would create a new-subchapter in Chapter 11 for financial institutions with financial assets of at least $50 billion.[13] Additionally, on June 10, 2017 the House of Representatives passed the Financial CHOICE Act of 2017 ("CHOICE Act").[14] The CHOICE Act repeals a number of provisions of the Dodd-Frank Act, including the Orderly Liquidation Authority,[15] the Consumer Financial Protection Bureau,[16] and the Volcker Rule,[17] among a number of other provisions.[18]

This comment argues that FIBA and the CHOICE Act place too much power and freedom back in the hands of those who bear substantial responsibility for the worst economic

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[11] Bruce Grohsgal, *Do the Financial Institution Bankruptcy Act and the CHOICE Act Undermine an Effective Restructuring of a Failing Financial Institution?*, HARV. L. SCH.: BANKR. ROUND TABLE (Jun. 13, 2017), http://blogs.harvard.edu/bankruptcyroundtable/2017/06/13/financial-institution-bankruptcy-act/ (noting that both the Financial Institution Bankruptcy Act and the Financial CHOICE Act would repeal key provisions of the Dodd-Frank Act).

[12] Financial Institution Bankruptcy Act of 2017, H.R. 1667, 115th Cong. (2017).

[13] Financial Institution Bankruptcy Act of 2017, H.R. 1667, 115th Cong. §§ 2(a)(9A)(B), 2(b)(1) (2017).

[14] H.R. 10, 115th Cong. (2017).

[15] H.R. 10, 115th Cong. § 111 (2017).

[16] *Id.* at § 711.

[17] *Id.* at § 901.

[18] *See id.*

crisis since the Great Depression.[19] The Dodd-Frank Act is by no means a perfect solution to the problems stemming from the Great Recession.[20] However, the proposed bills purport to strip away key provisions of the Dodd-Frank Act and replace them with token gestures of regulation that allow financial institutions many of the freedoms they enjoyed prior to the financial crisis of 2007.[21] Simply because the United States economy has weathered the financial tumult of the crisis does not mean that we can afford to relax financial regulations.[22] FIBA and the Financial CHOICE Act propose dangerous relaxations of crucial financial regulations, which may allow the United States to fall back into the mire of financial corruption, misguided monetary policy, and unchecked corporate greed.[23] In the absence of meaningful alternative financial regulations, Dodd-Frank must be upheld, perhaps alongside FIBA, rather than only the FIBA and CHOICE Acts.[24]

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[19] *See* Josh Bivens, *Worst Economic Crisis Since the Great Depression? By a Long Shot.*, ECON. POL'Y INST: ECON. SNAPSHOT (Jan. 27, 2010), http://www.epi.org/publication/snapshot_20100127/; *infra* Part II.B.
[20] *Id.*
[21] *See infra* Part II.C.
[22] *Id.*
[23] *See infra* Parts II.B., II.C.
[24] Mark J. Roe, *Financial Scholars Oppose Eliminating "Orderly Liquidation Authority" As Crisis-Avoidance Restructuring Backstop*, HARV. L. SCH., (May 26, 2017), https://corpgov.law.harvard.edu/2017/05/26/financial-scholars-oppose-eliminating-orderly-liquidation-authority-as-crisis-avoidance-restructuring-backstop/.

## I. THE DODD-FRANK ACT: ESTABLISHING TRANSPARENCY IN THE MURKY WORLD OF WALL STREET

### A. The Need for Economic and Moral Reform

The driving force behind the Great Recession was the abrupt drop of housing prices in 2007, following years of steep increases.[25] The housing crisis was exacerbated by reckless lending practices and excessive risk taking, resulting in major financial institutions sustaining massive losses.[26] During the housing crisis, a number of the most prominent financial institutions in the United States reported staggering, and sometimes fatal, losses.[27] The dire status of the United States financial sector prompted a tax-payer funded government bailout for many major institutions and on September 28, 2009, Congress passed a $700 billion bailout plan.[28] However, even after the bailout plan passed, confidence in the American financial market remained low amongst both financial institutions themselves and the American people.[29] As a result, the era of "easy credit, over-indulgence, and over-leveraging" gave way to an era of unemployment, reduced consumer spending, and distrust in the American financial market that had not been seen in

[25] Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANK. INST. 5, 7 (2009).
[26] *Id.*
[27] *Id.* at 8-9 (noting that the financial crisis led to the extinction of financial giants Bear Sterns and Lehman Brothers; financially crippled a number of preeminent financial institutions such as Merrill Lynch, Wachovia, A.I.G., Citigroup, Fannie Mae, and Freddie Mac; facilitated the failure of large savings and loan companies Washington Mutual and IndyMac Bank; and led to the extinction of the last two large independent invest banks in existence: Morgan Stanley and Goldman Sachs).
[28] *Id.* at 78.
[29] *Id.* at 79; McCarthy, *supra* note 2.

decades.[30] In response, the American public demanded accountability from Wall Street.[31]

### B. Key Provisions of the Dodd-Frank Act: The Orderly Liquidation Authority

The Dodd-Frank Act establishes an organization known as the Orderly Liquidation Authority ("the OLA").[32] The OLA is an authority that is empowered to quickly handle the liquidation of major financial institutions during times of economic crisis.[33] Rather than bankruptcy judges, the OLA is comprised of financial regulators and financial experts.[34] In addition to the Orderly Liquidation Authority, Title II of the Dodd-Frank Act also creates the Orderly Liquidation Fund.[35] This fund authorizes the OLA to issue loans to financial institutions that are deemed "systemically important."[36]

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[30] Moran, *supra* note 25, at 99-100.

[31] *See* Daniel Kaufman, *Corruption and the Global Financial Crisis*, FORBES (Jan. 27, 2009), https://www.forbes.com/2009/01/27/corruption-financial-crisis-business-corruption09_0127corruption.html#38fd183061b3 (contending that "[d]eep-seated transparency reforms need to be a cornerstone" of financial reform and these reforms "should apply to U.S. public agencies as well as domestic and international financial institutions.").

[32] 12 U.S.C.A. § 5384 (2015).

[33] Paul L. Lee, *The Dodd-Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique – Part II*, 128 BANK. L.J. 867, 867 (2011).

[34] Ben S. Bernanke, *Why Dodd-Frank's Orderly Liquidation Authority Should Be Preserved*, BROOKINGS INST. (Feb. 28, 2017), https://www.brookings.edu/blog/ben-bernanke/2017/02/28/why-dodd-franks-orderly-liquidation-authority-should-be-preserved/.

[35] 12 U.S.C.A. § 5384 (2015).

[36] Aaron Klein, *A Primer on Dodd-Frank's Orderly Liquidation Authority*, BROOKINGS INST. (Jun. 5, 2017), https://www.brookings.edu/blog/up-front/2017/06/05/a-primer-on-dodd-franks-orderly-liquidation-authority/ (explaining that "Dodd-Frank extended the FDIC's authority to resolve failed institutions beyond commercial banks to include the entire bank

These loans have come under heavy criticism for serving as nothing more than a façade for more taxpayer bailouts.[37] However, the loans are not taxpayer bailouts because the Dodd-Frank Act mandates that these loans are backed by the assets of the financial institutions. Moreover, these loans are recovered during the resolution process, and if recovery is not feasible, loans will otherwise be obtained from other major financial institutions.[38]

### C. Key Provisions of the Dodd-Frank Act: Consumer Financial Protection Bureau

Title X of the Dodd-Frank Act establishes the Consumer Financial Protection Bureau ("the CFPB").[39] The CFPB was designed with the intent of curbing many of the regulatory deficiencies leading up to and culminating in the financial crisis of 2007-2008.[40] The CFPB was designed to consolidate a wide array of financial regulations, prevent consumer protection from being "subordinated to regulatory concerns about bank profitability," and ensure that financial regulators wield the necessary and requisite financial expertise to ensure implementation of effective regulations.[41]

Congress empowered the CFPB with general rulemaking, supervision, and enforcement authority over a wide array of institutions that fall within the ambit of the consumer financial services industry.[42] The CFPB has broad authority to hold large financial institutions to stricter rules

holding company and all firms designated as Systemically Important Financial Institutions (SIFIs).").

[37] Roe, *supra* note 24.

[38] *Id.*

[39] 12 U.S.C. § 5491 (2012).

[40] Webel, *supra* note 6, at 10.

[41] Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 331, 343 (2013).

[42] *Id.* at 322.

and regulations concerning transparency and stability.[43] Such broad authority over the financial markets has garnered substantial criticism by many who fear that with such vast authority, regulators will again rescue failing financial institutions with taxpayer dollars.[44]

### D. Key Provisions of the Dodd-Frank Act: The Volcker Rule

Another key provision of the Dodd-Frank Act, the Volcker Rule, implements a ban commercial banks engaging in proprietary trading.[45] Proprietary trading is high-risk trading, wherein bank employees will engage in highly speculative trading in order to make a profit for the bank rather than the bank's customers.[46] In the early 2000s proprietary trading was commonplace, as banks and their affiliates ran rampant with morally and financially dubious investments and trade deals in search of higher profits, salaries, and bonuses.[47] Furthermore, proprietary trading

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[43] Webel, *supra* note 6, at 11-12.
[44] Steven A. Ramirez, *Dodd-Frank as Maginot Line*, 15 CHAP. L. REV. 109, 123 (2011) (explaining that many financial experts believe that "too many avenues remain open for regulators to rescue creditors of large banks, and that those regulators now have a proven track record of indulging powerful bank interests").
[45] 12 U.S.C. § 1843 (2012).
[46] Stacy Goto Grant, *Note, International Financial Regulation Through the G20: The Proprietary Trading Case Study*, 45 GEO. J. INT'L L. 1217, 1221 (2014).
[47] Jeff Merkley & Carl Levin, *The Dodd-Frank Act Restrictions on Proprietary Trading and Conflicts of Interest: New Tools to Address Evolving Threats*, 48 HARV. J. ON LEGIS. 515, 522 (2011) (labeling proprietary trading methods of major financial institutions prior to the financial crisis of 2007-2008 as "increasingly complex and risky"); Onnig H. Dombalagian, *Proprietary Trading: Of Scourges, Scapegoats, and Scofflaws Twenty-Fifth Annual Corporate Law Symposium:*

presents substantial conflict of interest issues between large banks and their customers.[48] By engaging in highly speculative and risky trading on the customers' behalf, banks create the potential for generating profits at the expense of their own clients.[49] The Volcker Rule sought to put an end to the risks and moral quandaries that accompany proprietary trading.[50]

## II. FIBA AND THE FINANCIAL CHOICE ACT: PUTTING TRUST INTO THE HANDS OF THE UNTRUSTWORTHY

With the FIBA and the CHOICE Act Congress has made a clear push to put power back in the hands of the major financial institutions.[51] Both FIBA and the CHOICE Act will impose substantial changes to the manner in which major financial institutions are processed in times of economic crisis.[52] Furthermore, the CHOICE Act would mandate major changes to the CFPB and its authority to regulate major financial firms.[53] Additionally, the CHOICE Act includes a repeal of the Volcker Rule, which will allow commercial banks to engage in high risk, speculative trading conducted solely for the profit of the bank.[54]

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*Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act*, 81 U. CIN. L. REV. 387, 388 (2012).

48 Onnig H. Dombalagian, *Proprietary Trading: Of Scourges, Scapegoats, and Scofflaws Twenty-Fifth Annual Corporate Law Symposium: Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act*, 81 U. CIN. L. REV. 387, 388 (2012).

49 *Id.*

50 12 U.S.C. § 1843 (2012).

51 *See infra* Part III.

52 *See supra* notes 13-15.

53 *See supra* note 16.

54 *See supra* note 17.

### A. Repeal of the Orderly Liquidation Authority

If enacted into law, FIBA would essentially dissolve the OLA and allow failing financial firms to restructure in bankruptcy court.[55] However, dissolving the OLA may actually hurt the efficacy of many of FIBA's key provisions.[56] The stated purpose of the OLA is to quickly and efficiently liquidate failing financial firms in times of financial crisis.[57] Simply put, bankruptcy courts are not as well situated to quickly and efficiently handle the liquidation of failing financial firms as the OLA is.[58] The OLA and its members wield a number of skills and benefits that only they are equipped to provide, including: knowledge and expertise of American and international financial markets; the ability to plan and monitor for the possibility of a financial meltdown; coordination; and liquidity.[59]

First and foremost, the OLA is comprised of financial regulators, many of whom have spent their entire career working in the financial industry.[60] Not only do these regulators possess an extensive knowledge and understanding of the American and global financial markets, but they also possess the requisite contacts to coordinate large scale liquidation of financial institutions with offices

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[55] Financial Institution Bankruptcy Act of 2017, H.R. 1667, 115th Cong. (2017).
[56] Letter from Jeffrey Gordon, et al., Professor, Columbia Law School, to members of Congress (May 23, 2017) (on file with author) (explaining that "[f]or FIBA to function properly, it needs institutional supports that only the OLA and its related rules now provide, making FIBA inadequate as the sole resolution mechanism available in a crisis.").
[57] 12 U.S.C.A. § 5384 (2015).
[58] Bernanke, *supra* note 34 (declaring that "[i]t is simply not plausible that judges would be as effective as financial regulators in preparing for a speedy resolution or in managing one during a period of high financial stress.").
[59] *See* Gordon, *supra* note 56; Bernanke*, supra* note 34.
[60] Bernanke, *supra* note 34.

across the world.[61] Under the current provisions of the OLA, regulators are authorized to initiate the liquidation proceedings.[62] However, this authority would be abolished under FIBA, wherein proceedings may only begin once a financial institution has filed for bankruptcy.[63] Being able to initiate liquidation proceedings is critical, as it allows regulators to communicate with and acclimatize foreign regulators to the bankruptcy process.[64] Otherwise foreign regulators are liable to seize the assets of the financial institution within their jurisdiction, which is often the "death knell" for successful bankruptcies.[65]

Furthermore, the Dodd-Frank Act requires systemically important financial institutions to maintain living wills that provide a plan for their resolution in the event of a financial crisis.[66] These living wills allow the OLA to plan for any potential financial crisis and monitor the market and the individual financial firms for signs of impending financial stress, and plan appropriate remedial measures.[67]

Lastly, the OLA is authorized to provide liquidity to financial firms when it is deemed necessary.[68] Liquidity is often vital to stabilizing financial firms.[69] However, liquidity may only be provided through an FDIC receivership, which includes the OLA—bankruptcy judges cannot provide

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[61] Gordon, *supra* note 56 (asserting that "[a] U.S. bankruptcy court will lack deep prior relationships or the authority to reach understandings with foreign regulators in advance of a bankruptcy filing.").
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(d), 12 U.S.C. § 5325 (2012).
[67] Gordon, *supra* note 56; Bernanke, *supra* note 34.
[68] 12 U.S.C.A. § 5384 (2015).
[69] Gordon, *supra* note 56.

liquidity.[70] Moreover, in addition to the liquidity support itself, public knowledge of the liquidity is often immensely important in stabilizing financial markets and ensuring the American public retains confidence in the American financial industry.[71]

In short, the OLA provides a number of key benefits that are unique in this day in age.[72] The FIBA and the Financial CHOICE Act abolish the OLA and replace it with a court system that is ill-equipped to handle the dissolution of financial firms in times of economic crisis.[73] The vigor of the system proposed by these acts would be severely diminished by the repeal of the OLA.[74] If this proposed system is to be enacted, it must be enacted alongside the OLA, not in place of the OLA.[75]

### B. Reprieve from Enhanced Prudential Regulations

The Financial CHOICE Act proposes to replace the CFPB with the Consumer Law Enforcement Agency (the "CLEA").[76] The CLEA would inherit many of the same rulemaking authorities of the CFPB, however, it would not retain the authority to conduct examinations or supervise any of the activities of major financial firms.[77] Furthermore, the CLEA would be required to conduct a cost-benefit analysis of every

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[70] *Id.*
[71] *Id.*
[72] *See infra* note 58 and accompanying text.
[73] Randall D. Guynn, *Are Bailouts Inevitable*, 29 YALE J. ON REG. 121, 137 (2012) (explaining that the stresses of a global financial panic expose the weaknesses of the Bankruptcy Code when it is the only available option).
[74] Gordon, *supra* note 56.
[75] *Id.*
[76] MARC LABONTE, ET AL., CONG. RESEARCH SERV., THE FINANCIAL CHOICE ACT IN 115TH CONGRESS: SELECTED POLICY ISSUES 29 (2017).
[77] *Id.*

proposed enforcement action prior to implementing or engaging in such actions.[78] And unlike the CFPB, the CLEA would not have the authority to "prohibit unfair, deceptive, and abusive acts or practices in consumer financial markets."[79]

In addition to the loosening of regulatory restrictions precipitated by the proposed changes to the CFPB, the Financial CHOICE Act also provides a "regulatory off-ramp" for major financial institutions.[80] This "regulatory off-ramp" essentially allows for financial institutions that are covered by the current regulatory standards to opt out of enhanced regulations[81] in exchange for subjecting the institution to a higher, ten percent leverage ratio.[82]

These proposed changes represent an abrupt shift in economic regulation; scaling back many of the more robust features of the Dodd-Frank Act.[83] Such a drastic reduction in economic regulation is troubling because it represents a

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[78] *Id.*

[79] *Id.*

[80] Lee A. Meyerson & Spencer A. Sloan, *Treasury Department Issues Recommendations on Reforming the U.S. Financial System*, HARV. L. SCH., (Jun. 23, 2017), https://corpgov.law.harvard.edu/2017/06/23/treasury-department-issues-recommendations-on-reforming-the-u-s-financial-system/.

[81] These regulations include, but are not limited to: risk-based and leverage capital requirements, liquidity standards, requirements for overall risk management (including establishing a risk committee), stress-test requirements, and a 150-to-1 debt-to-equity limit for companies that the Financial Stability Oversight Committee has determined pose a grave threat to financial stability. 12 C.F.R. § 252.32-35 (2018).

[82] Labonte, *supra* note 76, at 6.

[83] Paul Lee, *The CHOICE Act Is a Bad Choice for Financial Reform*, THE CLS BLUE SKY BLOG: COLUM. L. SCH., (Sep. 26, 2017) (observing that "[t]here are few precedents in modern political history for such a rapid and fundamental reversal of course," and that the Financial CHOICE Act would "repeal or severely circumscribe most of the Dodd-Frank Act provisions aimed at systemic risk.").

"social amnesia."[84] In scaling back regulations, Congress again opens the door for financial institutions to engage in morally and financially suspect deals that may drag the American economy into another financial crisis.[85] Indeed, many of the regulations proposed by the Financial CHOICE Act are not economically viable.[86] For example, currently none of the largest American banks are capable of meeting the ten-percent leverage ratio required for the "regulatory off-ramp."[87] Moreover, many experts question the wisdom of using a sole measure, such as the ten percent leverage ratio in this case, to measure the financial health of an institution.[88] The "regulatory off-ramp" stands as an example of the broader objective of the aims of the Financial Choice Act: deregulation.[89]

The Financial CHOICE Act replaces the CFPB with an agency that has far less authority to stamp out financially and morally dubious banking practices.[90] Additionally, the CHOICE Act purports to allow for financial institutions to escape the enhanced standards Dodd-Frank established in exchange for meeting a standard that none of the major banks are capable of meeting.[91] In short, the Financial CHOICE Act repeals a vast majority of the regulations designed to prevent another financial crisis all in the name

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[84] John C. Coffee Jr., *Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated Symposium: Financial Regulatory Reform in the Wake of the Dodd-Frank Act*, 97 CORNELL L. REV. 1019, 1078 (2012).
[85] *Id.* at 1079.
[86] Lee, *supra* note 83.
[87] *Id.*
[88] *Id.*
[89] 163 CONG. REC. H4717 (daily ed. June 8, 2017) (statement of Rep. Waters) (labeling the Financial CHOICE Act a "vehicle for Donald Trump's agenda to deregulate and help out Wall Street.").
[90] Labonte, *supra* note 76, at 29.
[91] Lee, *supra* note 83.

of increasing short term financial growth.[92] The CHOICE Act represents a myopic aim of short-term financial growth at the potential cost of another financial crisis in the mold of the Great Recession.[93]

### C. Decrease in Financial Stress-Testing

One of the cornerstones of the proposed CHOICE Act, the "regulatory off-ramp," allows major financial institutions to regain many of the liberties they enjoyed prior to the financial crisis of 2007.[94] This "regulatory off-ramp" would allow for a drastic reduction in financial stress testing requirements in systemically important financial institutions.[95] Stress testing requires financial institutions to maintain capital that is not tied up in bad loans or risky investments.[96] These financial stress tests seek to ensure that financial systems are capable of surviving another financial disaster precipitated by a wide array of factors.[97] The Federal Reserve currently runs financial systems through a litany of hypothetical scenarios to help mold financial regulations and assess the capabilities of American financial institutions to weather the storm of another financial disaster.[98] For example, in 2016 the Federal Reserve implemented a stress test in which banks were forced to assess their ability to cope with negative U.S. short-term Treasury rates, in addition to major losses to their

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92 *Id.*
93 Coffee, *supra* note 84.
94 H. Rodgin Cohen & Samuel R. Woodall III, *Financial CHOICE Act of 2017*, HARV. L. SCH.: F. CORP. GOV'T FIN. REG. (Jun. 15, 2017), https://corpgov.law.harvard.edu/2017/06/15/financial-choice-act-of-2017/.
95 *Id.*
96 Margaret Ryznar et al, *Implementing Dodd-Frank Act Stress Testing*, 14 DEPAUL BUS. & CO. 323, 324 (2016).
97 *Id.* at 325.
98 *Id.*

corporate and commercial real estate lending portfolios.[99] Thus, stress testing is "an important macroprudential regulatory tool," as it enables financial regulators to attain a "deeper and broader view of the future health" of financial institutions under a myriad of scenarios.[100]

The Financial CHOICE Act of 2017 seeks to implement a number of modifications to current stress testing standards that would profoundly inhibit the efficacy of the testing.[101] First and foremost, the Comprehensive Capital Analysis and Review ("CCAR") process would be conducted every two years, rather than every year.[102] The CCAR process is the method by which financial regulators determine whether a financial institution has an adequate amount of capital to survive another financial disaster.[103] In addition to limiting application of the CCAR process to every two years, the Financial CHOICE Act would also eliminate all mid-year stress test processes.[104] Furthermore, the Federal Reserve would be required to disclose the economic conditions used for stress testing, as well as solicit public comment on these conditions.[105] The Financial CHOICE Act of 2017 would also prohibit the Federal Reserve from using the CCAR qualitative assessment to prohibit a bank from making a planned distribution.[106] Under the current system a dedicated supervisory team, run by the Federal Reserve,

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[99] *Id.*

[100] Behzad Gohari & Karen E. Woody, *The New Global Financial Regulatory Order: Can Macroprudential Regulation Prevent Another Global Financial Disaster?* 40 J. CORP. L. 403, 432 (2015).

[101] Cohen & Woodhall, *supra* note 94.

[102] *Id.*

[103] *Stress Tests and Capital Planning*, FED. RES. (Mar. 7, 2017), https://www.federalreserve.gov/supervisionreg/stress-tests-capital-planning.htm.

[104] Cohen & Woodhall, *supra* note 94.

[105] *Id.*

[106] *Id.*

has the authority to object to a financial institution's capital plan, based on the firm's qualitative assessment.[107] Therefore, under the rules proposed by the CHOICE Act of 2017, even if a qualitative assessment reveals that a financial institution has a substantial lack of capital to survive a financial disaster, the Federal Reserve is powerless to prevent the institution from engaging in bad loans and risky investments.[108]

The essence of stress testing is ensuring that financial systems are healthy and capable of surviving another financial disaster.[109] The CHOICE Act of 2017 seeks to implement significant reductions in the vitality of stress testing.[110] However, the American financial sector is ill-prepared for such a drastic reduction in stress testing.[111] Citigroup has failed Dodd-Frank stress tests twice, and Goldman Sachs and Bank of America would have failed if they had not amended their capital distribution.[112] A critical factor in the facilitation of the financial crisis of 2007-2008 was a profound lack of financial stress testing—banks were simply unaware of how their institution would cope with the advent of financial crisis.[113] Moreover, the implementation of stress testing throughout the financial sector has found "great success both for the health of the institutions and the

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[107] *Qualitative Assessment Framework, Process, and Summary of Results,* FED. RES. (Aug. 23, 2017), https://www.federalreserve.gov/publications/2017-june-ccar-assessment-framework-results-qualitative-assessment.htm (explaining that dedicated supervisory teams have the authority to "formulate a recommendation" to the Federal Reserve "to object or not to object to a firm's capital plan based on" the qualitative assessment).

[108] Cohen & Woodhall, *supra* note 94.

[109] Ryznar et al., *supra* note 96.

[110] *See* Cohen & Woodhall, *supra* note 94, at 325.

[111] Ryznar et al., *supra* note 96, at 346.

[112] *Id.* at 325=26.

[113] Eugene A. Ludwig, *Assessment of Dodd-Frank Financial Regulatory Reform: Strengths, Challenges, and Opportunities for a Stronger Regulatory Reform*, 29 YALE J. ON REG. 181, 186 (2012).

marketplace."[114] Therefore, financial stress testing should not be scaled down merely because financial institutions have survived the financial crisis of 2007-2008 and the ensuing financial turmoil.[115]

Conversely, some commentators argue that the current stress testing protocols do not go far enough to ensure that financial institutions are capable of surviving yet another financial meltdown.[116] Robert Weber contends that current stress testing procedures are more akin to "audit-like exercises that validate existing business practices and mathematical models," than earnest attempts to discern the financial vitality of systemically important financial institutions.[117] For financial regulations to work to their full potential, stress testing of financial regulations must truly be "conceptualized as multi-actor deliberations on how a firm might fail."[118] Thus, while the stress testing regulations implemented by Dodd-Frank are a step in the right direction, they must evolve into more comprehensive and vigorous evaluations in order to truly ensure the health of financial institutions.[119] Ultimately, if current financial stress testing does not go far enough to ensure the health of major financial institutions, the regulations should be enhanced, not repealed.[120]

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[114] *Id.*
[115] Daniel K. Tarullo, *The Departing Remarks of Federal Reserve Governor Daniel K. Tarullo*, HARV. L. SCH.: F. CORP. GOV'T FIN. REG. (May 1, 2017), https://corpgov.law.harvard.edu/2017/05/01/the-departing-remarks-of-federal-reserve-governor-daniel-k-tarullo/ (warning that "it is crucial that the strong capital regime [of current stress testing procedures] be maintained").
[116] Robert F. Weber, *The Corporate Finance Case for Deliberation-Oriented Stress Testing Regulation*, 39 J. CORP. L. 833, 834 (2014).
[117] *Id.*
[118] *Id.*
[119] *Id.* at 857.
[120] *Id.*

### D. Repeal of the Volcker Rule

Title IX of the Financial CHOICE ACT provides for the repeal of the Volcker Rule.[121] As previously mentioned, the Volcker Rule acts as a ban on proprietary trading – or what amounts to highly speculative and risky trading that only the bank stands to profit from.[122] The Volcker Rule was enacted in order to prevent highly speculative trading, as well as the conflicts of interests that arise out of this trading, where banks may be incentivized to mislead or deceive their own customers regarding the buying of securities.[123]

Deregulation allowed commercial banks to compete with investment banks and securities firms through high risk and complex proprietary trading.[124] Commercial banks became increasingly reliant on proprietary trading as a form of revenue.[125] However, proprietary trading left banks financially vulnerable; in the fourth financial quarter of 2007 losses from proprietary trading amounted to almost 250 percent of net operating revenue.[126] In addition to the risky and speculative nature of the deals, proprietary trading carries an innate propensity to create conflicts of interest among large financial institutions.[127] Proprietary trading creates situations where financial institutions stand to profit by either marketing products to their own clients that are designed to fail or using client trading information against

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[121] H.R. 10, 115th Cong. § 901 (2017).
[122] Grant, *supra* note 46.
[123] Andrew F. Tuch, *Conflicted Gatekeepers: The Volcker Rule and Goldman Sachs*, 7 VA. L. & BUS. REV. 365, 373 (2012).
[124] Grant, *supra* note 46, at 1226-27.
[125] Merkley & Levin, *supra* note 47.
[126] *Id.*
[127] *Id.* (explaining that proprietary trading provides an "increasingly irresistible" temptation for large financial firms, thereby often leading to conflicts of interest between the bank and its clients).

the interests of that same client by leveraging the client information to secure better trading deals for the bank itself.[128] Repeal of the Volcker Rule would allow banks to once more engage in trade deals that crippled domestic and international financial markets[129] and turned them against their own clients.[130] The best way to ensure that financial institutions do not repeat past behavior of treacherous trade deals and rampant conflicts of interest is through a robust regulation system.[131] Nevertheless, the Financial CHOICE Act seeks to repeal the very rule that prohibits a substantial amount of the activity that contributed to the financial crisis and once more allows large financial institutions the freedom to leverage the money of their own client for speculative gains of megabanks.[132]

### E. Culture Change: Diversifying and Regulating

As previously discussed, the financial crisis of 2007-2008 was ushered in by an era of deregulation that gave way to reckless and irresponsible financial decisions.[133] However, these poor financial decisions were, in turn, precipitated by a culture within many large firms that encouraged and glorified profits

[128] *Id.* at 522-526.
[129] *Id.* at 515 (stating that proprietary trading "played a critical role" in creating the financial crisis of 2007-2008).
[130] *Id.* at 522.
[131] Merkley & Levin, *supra* note 47, at 553 (declaring that the financial crisis of 2007-2008 was created by "poor policy choice and lax regulation" allowing for proprietary trading to continue unabated").
[132] *Id.*
[133] Kristin Johnson et al., *Diversifying to Mitigate Risk: Can Dodd-Frank Section 342 Help Stabilize the Financial Sector*, 73 WASH. & LEE. L. REV. 1795, 1797 (2016) (explaining that many large financial firms "engineered and invested in high risk financial instruments that ultimately generated large losses" which in turn "triggered a run on the shadow banking sector and later crippled the conventional banking sector and spelled calamity for the global economy.").

at any cost, and ultimately facilitated financial disaster.[134] Dodd-Frank was intended to change both the culture surrounding regulation of financial firms, as well as the culture within financial firms.[135]

### *1. Promoting Diversity and Stability*

Prior to the financial crisis, many firms were blighted by "[u]nprecedented compensation and brazen behavior," which gave way to an "environment devoid of accountability."[136] The American financial sector was dominated by a culture of "egotism and bravado" that only exacerbated poor financial decisions and a disregard for financial accountability and stability.[137] Wall street was dominated by the "cowboy culture" of major financial institutions, where the corporate culture "feeds on itself, and people rise up the ranks, who are its exemplars and cheerleaders and who are risk takers, too."[138] Corporate culture was warped into a culture that glorified financial gain above all else and fostered a culture of excessive risk taking and glorification of money, thereby creating a culture that would lead to financial disaster.[139]

In response to this toxic culture, Dodd-Frank instituted a number of reforms to increase diversity and

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[134] *See* FIN. CRISIS INQUIRY COMM'N, THE FIN. CRISIS INQUIRY REP. xix 2011 (finding that the financial crisis was facilitated by "stunning instances of governance breakdowns and irresponsibility" within major financial institutions).

[135] *See generally* Johnson et al., *supra* note 133.

[136] Johnson et al., *supra* note 133, at 1799.

[137] *Id.* at 1801.

[138] *Id.* at 1802; Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture, and Ethics of Financial Risk Taking,* 96 CORNELL L. REV. 1209, 1239 (2011).

[139] *See generally* Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture, and Ethics of Financial Risk Taking,* 96 CORNELL L. REV. (2011).

inclusions within corporate structures.[140] Prior to the passage of the Dodd-Frank Act, only two of the twenty-five largest banks in the county were headed by a minority, and none were headed by a woman.[141] Section 342 provided for a number of reforms seeking to foster a new culture of financial responsibility and accountability within financial institutions.[142] For example, Section 342 requires all federal agencies to establish an Office of Minority and Women Inclusion.[143] The Office of Minority and Women Inclusion is responsible for ensuring that diversity is leveraged throughout the agencies and in all matters governed by each respective agency.[144]

Reforms promoting diversity within corporate structure may prove to have profound effects on the stability of the financial sector.[145] For example, one study found women to be more risk averse than men.[146] Furthermore, African-American and Hispanic households "also display more risk aversion than white households in their investment choices," in the post financial crisis era.[147] Additionally, there is substantial data to suggest that market bubbles are fueled by the "ethnic homogeneity of traders," which "imbues people with false confidence in the judgment of coethnics, discouraging them from scrutinizing

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[140] 12 U.S.C. § 5452 (2012).
[141] Johnson et al., *supra* note 133, at 1843.
[142] *Id.*
[143] *Id.*
[144] *Id.* (providing that the Office of Minority and Women Inclusion "shall be responsible for all matters of the agency relating to diversity in management, employment, and business activities").
[145] *See generally* Johnson et al., *supra* note 133.
[146] Rachel Croson & Uri Gneezy, *Gender Differences in Preferences,* 47 J. ECON. LITERATURE 1, 7 (2009).
[147] Johnson et al., *supra* note 133, at 1812.

behavior."[148] Studies have further suggested that firms with a high degree of diversity amongst governing boards "achieve higher corporate social responsibility ratings."[149]

### 2. *Regulating a Deregulated Industry*

Generally, in the years leading up to the financial crisis, the financial sector was regulated by way of deregulation; the market was seen as a self-regulating entity.[150] This period of deregulation gave financial institutions a wide berth to engage in behavior that resulted in short-term gains, but later resulted in financial catastrophe.[151]

Dodd-Frank is a direct response to the years of deregulation and systemic deficiencies in stability and accountability.[152] Dodd-Frank implements a number of measures that are directly tailored to combat the excessive risk taking and lack of accountability that directly facilitated the Great Recession.[153] Dodd-Frank—and the broader scheme of regulation that it represents, macroprudential regulation—is actively seen as "the most credible policy and regulatory mechanism for the prevention of systemic shocks,

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[148] *Id.* at 1814 (citing Sheen S. Levine et al., *Ethnic Diversity Deflates Bubble Prices*, 111 PROC. NAT'L ACAD. SCI. 18524, 18524 (2014)).
[149] *Id.* at 1816.
[150] *The Causes and Current State of the Financial Crisis Before the Financial Crisis Inquiry Commission*, FDIC.GOV (Jan. 14, 2010) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) (explaining that for the past two decades there was "a world view that markets were, by their very nature, self-regulating and self-correcting"), https://www.fdic.gov/news/news/speeches/chairman/spjan1410.html.
[151] *Id.* (explaining that market discipline allowed for "the excesses of the past few years," and that "the regulatory system also failed in its responsibilities").
[152] *Id.*
[153] *See supra* Part I.

and the management of any systemic risk in the financial services industry."[154]

As such, Dodd-Frank's reforms are critical pieces of legislation that seek to remedy the systemic issues culminating in the Great Recession.[155] Yet the reforms are also highly important for what they represent: a repudiation of the practices that crippled the American economy.[156] Dodd-Frank represents an acknowledgement of the importance of financial accountability and stability, as well as the critical role that diversity plays in upholding those ideals.[157] The Financial CHOICE Act not only repeals many key regulations that promote financial stability and accountability, but it repeals the culture change and reinstitutes the culture that glorified risky investments, a lack of accountability, and unbridled egotism and homogeneity.[158]

### *3. De-politicizing Regulation: Letting Regulators Regulate*

One of the central concepts at issue in the debate between Dodd-Frank and the CHOICE Act and FIBA is the extent of regulation.[159] Simply put, there is a burgeoning ideological

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[154] Gohari & Woody, *supra* note 100, at 437.
[155] *See supra* Part I.
[156] *See generally*, Johnson ET AL., *supra* note 133.
[157] *Id.*
[158] *Id.*
[159] Geoff Bennet, *House Passes Bill Aimed at Reversing Dodd-Frank Financial Regulations*, NPR (June 8, 2017), https://www.npr.org/2017/06/08/532036374/house-passes-bill-aimed-at-reversing-dodd-frank-financial-regulations (quoting co-author of the CHOICE Act, Rep. Jeb Hensarling, as stating that "Dodd-Frank represents the greatest regulatory burden on our economy"); *supra* note 89 (quoting Rep. Maxine Waters as labeling the CHOICE Act "a vehicle for Donald Trump's agenda to deregulate and help out Wall Street.").

rift as to how much regulation should be implemented and who should oversee the implementation.[160] The CHOICE ACT and FIBA intend to strip away many key financial regulations of Dodd-Frank and allow much greater freedom to major financial institutions.[161] Charles Murdock explains that a major issue with the proposed changes of the Financial CHOICE Act and FIBA "is that our financial regulators frequently come from the financial industry, and often go back to it."[162]

One of the cornerstones of the CHOICE Act is taking regulatory powers away from regulatory agencies and giving major financial institutions broader authority to regulate themselves.[163] Financial regulation over the past several decades has been defined by a "deregulatory mindset," as well as "timidity and deference to the banking regulators."[164] The financial crisis of the 2000s has proven that regulations cannot be implemented only when the financial sector is on the brink of crisis.[165] Rather, regulation must be robust and proactive.[166] Regulation is most effective when it is used as a platform to prevent systemically important financial

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[160] *See* H.R. REP. No. 115-153, pt. 1, at 2 (2017) ("*Demanding Accountability from Financial Regulators and Devolving Power Away From Wall Street*"); Ben Bernanke, *Ending "Too Big To Fail": What's the Right Approach?*, BROOKINGS INST., (May 13, 2016), https://www.brookings.edu/blog/ben-bernanke/2016/05/13/ending-too-big-to-fail-whats-the-right-approach/ (touting the success of and need for additional financial regulations in the wake of the financial crisis of 2007-2008).
[161] Gordon, *supra* note 56.
[162] Charles W. Murdock, *The Big Banks: Background, Deregulation, Financial Innovation, and Too Big to Fail*, 90 DENV. U. L. REV. 505, 553 (2012).
[163] *See generally*, *supra* Parts II.B, II.C, II.D.
[164] Murdock, *supra* note 162, at 555.
[165] David. A. Moss, *An Ounce of Prevention*, HARV. MAG. (Sept.-Oct. 2009), available at https://harvardmagazine.com/2009/09/financial-risk-management-plan.
[166] *Id.* at 28.

institutions from crippling the entire financial sector and spreading loss throughout the broader economy.[167]

Moreover, following the financial crisis of the 2000s, politicians in the United States and around the world assumed many of the responsibilities previously held by independent non-partisan financial regulators.[168] However, politicians are compelled to "make bailout decisions in the headwinds of electoral strategizing, ideological polarization, and interest group pressures."[169] Not only are independent regulators free from the political considerations that influence politicians, but independent financial regulators almost invariably possess the technical expertise required to effectively regulate the financial sector.[170] It is imperative that regulation of the American financial sector is left in the hands of independent regulators, and that regulations or deregulations are not implemented as a means of satisfying a political base.

## CONCLUSION

The Financial Institution Bankruptcy Act and the Financial CHOICE Act restore far too much freedom to the hands of persons and institutions that have proven they cannot be trusted to act without regulations and safeguards.[171] It is well established that the financial crisis of 2007-2008 was ushered in by an era of unchecked and unbridled greed, speculation, and excessive risk taking.[172] The Dodd-Frank Act is by no means a perfect solution to the systemic issues

[167] *Id.* at 27.
[168] Stavros Gadinis, *From Independence to Politics in Financial Regulation*, 101 CAL. L. REV. 327, 388 (2013).
[169] *Id.* at 389.
[170] *Id.*
[171] *See supra* Part II.C.
[172] *Id.*

that gave way to a financial meltdown. However, the Dodd-Frank Act must not be repealed without a meaningful replacement, as the Act helps to prevent the systemic risk that facilitated the financial crisis of 2007-2008.[173] FIBA and the CHOICE Act repeal a substantial portion of the Dodd-Frank Act without enacting meaningful reform to replace it.[174] By returning to an era of deregulation less than a decade after one of the greatest financial crises in this country's history, Congress has opened the door for financial institutions to once more betray the interests of their own clients and pursue risky and potentially ruinous investments and trade deals.[175] FIBA and the CHOICE Act represent a dangerous shift in financial legislation, once more opening the door for yet another financial disaster, all in the name of deregulation.[176]

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[173] *See* Coffee, *supra* note 84.
[174] Lee, *supra* note 83 (stating that "the CHOICE Act does not attempt to frame its own approach" to systemic approach in the financial industry, but rather the CHOICE Act "abandons the field").
[175] Merkley & Levin, *supra* note 47, at 553.
[176] *Id.*