Banking and Finance

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Access to capital is fundamental to the operation of a free society. It allows for the foundation, expansion, and smooth running of the private enterprises that make up the market economy. It also provides room for the experimentation that allows innovation in product and service delivery. A well-functioning financial system helps match investors with enterprises for mutual benefit—and to the benefit of their employees and customers. When too many restrictions are placed on the financial system, the economy slows both in its general flows and in innovation.

In the modern global economy, provision of access to capital generally occurs through the banking system as credit, through loans or credit cards. Once enterprises have reached a certain size, they can access capital markets, such as stock markets and debt offerings. Thanks to technological innovation, recent years have seen an explosion of alternative means of gaining capital—peer-to-peer lending and crowdfunding most prominent among them. At the individual household level, a variety of finance companies offer small-dollar loans that are often essential for keeping the lights on.

The smooth running of this system was disrupted by the financial crisis. A variety of government interventions, such as the Community Reinvestment Act and the actions of Fannie Mae and Freddie Mac, led lenders to overextend themselves by extending credit to a variety of sources that were unlikely to pay it back. Political convenience replaced sound economic judgment as a determinant of capital provision. A multitude of other factors added to the problem, including:

- The moral hazard of deposit insurance;
- Zoning restrictions that fueled unsustainable housing price rises;
- Loose monetary policy;
- Problems with bank modeling of risk; and
- International regulation (such as the Basel Accords on the risk weighting of capital assets) that inaccurately weighted the risk faced by debt holders.

When the banks that had extended the most problematic credit began to fail, government's reaction was to prop them up with taxpayer bailouts, thereby socializing their losses and breaking the incentive structure for avoiding such problems.

The Dodd-Frank Act of 2010 was meant to help solve the financial crisis, but in fact it did nothing to change the situation and made the problem worse. Instead, it doubled down on the bank regulatory regime that failed to prevent the financial crisis. In fact, Dodd-Frank regulates such extraneous issues as debit card interchange fees and accounting for conflict minerals that had nothing to do with the crisis.

Dodd-Frank was intended to address the problem of "too big to fail." It has failed to do so. The big banks are even more dominant than before the crisis, and the vastly increased regulatory burden imposed on smaller banks has led many of them to merge to create bigger banks that are able to withstand the increased regulatory costs. Some have even closed. Wall Street was targeted, but Main Street was hit.

Worse, banking regulators have abused their authority to crack down on legal businesses that regulators find distasteful.

This overregulation has made banks wary of lending to people without perfect credit or to small businesses and startups. These groups have turned to alternative sources of funds, but they are finding those attacked by regulators as well.

Even worse yet, Dodd-Frank created an unconstitutional and overly powerful regulator, the Consumer Financial Protection Bureau (CFPB), which lacks proper checks and balances.

Congress must rein in these regulators and pass laws that will rectify the mistakes of Dodd-Frank. The Financial CHOICE Act—for Creating Hope and Opportunity for

Investors, Consumers and Entrepreneurs—will go a long way toward righting the wrongs inflicted by Dodd-Frank.

The Financial CHOICE Act would:

- Assist in capital formation by allowing banks to swap less stringent regulation for holding more capital;
- Reduce the regulatory burden and make regulators accountable by reforming the Federal Reserve, the CFPB, and other regulators, while allowing meaningful relief from regulation for smaller institutions; and
- Provide a better solution to the too-big-to-fail problem by allowing for a new chapter in the bankruptcy code to replace the counterproductive "orderly liquidation authority" under Dodd-Frank.

Further reforms will be needed, including legislation to allow financial technology firms, known as FinTech, to pursue innovation in financial services without having to deal with the regulatory burdens of banks. An amended Fix Crowdfunding Act and other pieces of legislation described in detail in this section could help achieve that objective.