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Americans for Financial Reform
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PROTECT TAXPAYERS AND STOP WALL STREET'S PREDATORY BEHAVIOR IN MUNICIPAL FINANCE: OPPOSE HR 797

Dear Representative,

On behalf of the undersigned organizations, we urge you to OPPOSE HR 797. This legislation represents a major weakening of new protections created by the Dodd-Frank Act to prevent predatory behavior in Wall Street financial dealings with municipalities. These protections are critical to protecting taxpayers and citizens from exploitation.

The new protections created by the Dodd-Frank Act were a response to the revelation of massive financial abuses of municipal borrowers by Wall Street banks and derivatives dealers. The most notorious case was in Jefferson County, Alabama, which was driven into bankruptcy due to billions in losses suffered in exploitative swaps deals sold by JP Morgan Chase. But there are hundreds of other examples. The Justice Department has brought numerous criminal cases against major banks for manipulation and bid-rigging in the municipal bond markets. Across the country, hundreds of cities and towns have found themselves trapped in deceptive swaps deals requiring them to pay exorbitant fees. More recently, investigators have discovered that major banks engaged in large-scale manipulation of interbank (LIBOR) lending rates that resulted in artificially inflating municipal losses in swaps deals. Public entities, public employees, taxpayers, and users of public services across the country, including many members of our organizations, have been deeply harmed by this abusive behavior.

In response to these problems, Congress required financial advisors to municipalities to register with the Securities and Exchange Commission (SEC) and to follow a fiduciary duty to respect the best interests of taxpayers and the municipal client in giving financial advice. Thus, those providing financial advice to public entities will be required to hold to the highest ethical standards and refrain from any advice that would lead the municipality to engage in transactions that benefit the advisor at the expense of local taxpayers or governments.

HR 797 would weaken this protection in ways that are both harmful and unnecessary. The legislation is harmful because it would create significant new exemptions and loopholes. For example, any advice provided by a bank, a broker, a swaps dealer, or accountant that is in any way "related to or connected with" a municipal underwriting would be exempted from the fiduciary requirement. A similar exemption would be created for all advice provided by banks or swap dealers that is in any way “related to or connected with” the sale to municipalities of financial derivatives, loan participation agreements, deposit products, foreign exchange, or a variety of other financial products. The “related to or connected with” language added by HR 797 has been interpreted very broadly by the courts and would certainly permit major Wall Street banks to claim that they do not owe any fiduciary duty to respect taxpayer interests for advice given in the course of an underwriting or swaps deal. This would completely undermine the intent of the Dodd-Frank Act in protecting municipalities from harmful and self-serving financial advice.

HR 797 is also unnecessary, as existing law already contains exemptions from municipal advisor designation for a wide range of ordinary business dealings with municipalities. The Dodd-Frank Act also already exempts underwriters from advisor designation when they are simply acting as underwriters as defined in Section 2a(11) of the Exchange Act, as opposed to providing more extensive financial advice. The Dodd-Frank Act also authorizes additional exemptions from municipal advisor status in cases where it is justified. For example, beyond underwriters, both the Dodd-Frank Act and the SEC’s proposed rule also exempt investment advisors, engineers, commodity trading advisors, and attorneys in cases where these persons are providing specific types of professional advice and not recommendations on financial strategies. Finally, the mere provision of neutral financial information to a municipality would not constitute ‘advice’ triggering an advisor designation.

It is true that the initial SEC proposal defining municipal advisors was criticized by some for overreach in particular areas. For example, the proposal would have covered financial advice provided by elected or appointed public officials in their capacity as members of public advisory boards. However, the SEC has several times committed to fix this problem in the final rule, and narrow the definition of financial advisor to exclude public officials. Should the SEC not follow through on this commitment, Congress could legislate in this particular area once the final rule is passed. Criticisms concerning these relatively narrow issues should not lead Congress to pass a bill like HR 797, which contains broad and sweeping new exemptions that would fatally undermine important taxpayer protections in municipal finance

By passing this bill, Congress would unnecessarily create additional financial risks for states and localities and their accompanying residents who pay taxes and use public services. When states and localities suffer financial losses, the inevitable victims are local residents, who through no fault of their own, are faced with higher taxes or fewer services. The typical result is tax increases or budget cuts to education, health care, public safety, infrastructure, and other vital public services protecting the vulnerable and helping middle class families. Indeed, these outcomes are already being seen as municipalities across the country raise taxes or cut services to pay off Wall Street banks for exploitative financial deals. HR 797 would only increase the potential for such outcomes.

In sum, we urge you to OPPOSE HR 797 because it weakens accountability for financial advice to municipalities, harms communities, and is unnecessary given the exemptions that already exist in the law and the authority of the SEC to address any outstanding issues. If you have any questions, please contact Marcus Stanley at Americans for Financial Reform at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

AFL-CIO

American Federation of State, County and Municipal Employees (AFSCME)

Americans for Financial Reform

Consumer Federation of America

The Leadership Conference On Civil And Human Rights

Public Citizen

The Service Employees International Union (SEIU)

U.S. PIRG