AFR Americans for Financial Reform

March 2, 2016

Dear Representative,

On behalf of Americans for Financial Reform, we are writing here to express our opposition to seven of the bills under consideration before the Committee today. [1] (We have also written a separate letter expressing concerns about H.R. 4096).

Bills such as H.R. 4166 and H.R. 4620 would create major loopholes in key securitization market protections put in place by the Dodd-Frank Act. H.R. 2896 (the TAILOR Act) would impose dangerous and unnecessary new requirements on regulators that could result in the wholesale rollback of Dodd-Frank protections. H.R. 3798 establishes new barriers to legal accountability for corporate wrongdoers, H.R. 4498 creates an end run to even the minimal investor protections included in the JOBS Act, and H.R. 4638 creates trading venues for shares in private startup companies which would be exempted from a wide range of investor protections and pose clear risks of fraud and abuse.

These bills all move in the direction of less accountability for Wall Street, which is a move in precisely the wrong direction. The financial crisis of 2008 – and continuing examples of financial sector malfeasance and irresponsibility since then -- have made the need for more vigorous regulation painfully clear. Instead of working to eliminate consumer, investor, and systemic protections, the committee should focus on completing the job of strengthening them. This would increase the safety and stability of our economy and make financial markets work better for the public. It is also consistent with the views of the American public. Polls show that an overwhelming majority of the public, on a bipartisan basis, wants more accountability and oversight for Wall Street, not less.

Each of the seven bills addressed by this letter is discussed individually below.

H.R. 2896, the TAILOR Act, purports to simply require regulators to 'tailor' rules to the specific risks of financial institutions. But regulators have already taken extensive actions to adjust and modify their regulations to be appropriate for particular institutions and financial products. To take just two of many examples, the CFPB has exempted small community banks from numerous requirements associated with new 'qualified mortgage' rules, while the Federal Reserve has carefully scaled its capital requirements based on the size of bank holding companies, including differentiating rules for banks under $10 billion, banks sized $10 billion to $50 billion, banks sized $50 to $250 billion, and banks over $250 billion, with the strictest rules reserved for banks of over $250 billion that are classified as 'systemically important institutions'.

[1] Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

This ‘tailoring’ has taken place through the existing notice and comment process, which already leads regulators to examine issues raised by a wide range of commenters, and to consider the economic impact of their rules.

Since an appropriately 'tailored' approach to regulation is already in place, the main effect of H.R. 2896 would be to add numerous new 'cost benefit' type requirements that could block needed regulatory actions in the future. For example, the legislation adds a dozen new statutory requirements for agency consideration of different types of regulatory impacts, and requires agencies to document consideration of each type of regulatory impact in the rulemaking record, where it could be used as the basis for a lawsuit by Wall Street interests. The legislation also forces banking regulators to conduct a burdensome and time-consuming re-analysis of every single consumer and financial protection they have passed over the last five years in light of these statutory requirements. This is not an effort to improve regulation, but rather to create new roadblocks to agency action and to roll back recent financial regulatory efforts to protect consumers and the economy. We urge you to reject this legislation.

H.R. 3798, the “Due Process Restoration Act”, would extend special legal protections to companies charged with securities law violations by the SEC. Like other federal agencies, the SEC has authority to bring administrative proceedings against companies that violate federal securities law (in addition to civil actions). H.R. 3798 would allow companies to unilaterally terminate SEC administrative proceedings, leaving the SEC to either re-file in federal court or drop the charges. It would also significantly raise the burden of proof in administrative proceedings to require the SEC show clear and convincing evidence that the company violated the law.

These special protections are unnecessary as well as dangerous. Respondents in SEC hearings enjoy robust opportunities for discovery, a public hearing, and a decision made by a neutral administrative law judge with subject matter expertise. If companies are found to have violated the law, they are entitled to two full appeal processes, including a review in federal court.
At a time when the public is outraged about revelations of criminal behavior on Wall Street, Congress should not act to significantly limit regulatory enforcement powers. H.R. 3798 would do exactly this, and should be rejected.

H.R. 4139, the “Fostering Innovation Act”, doubles the length of the exemption from Sarbanes-Oxley Section 404(b) for ‘emerging growth companies’ from five years to ten years. The exemption applies to all companies with $50 million or less in annual gross revenues.

Section 404(b) requires the auditor of a public company to attest to the accuracy of the company’s financial reporting. This requirement was passed in response to the accounting scandals of the late 1990s, which revealed widespread deception and fraud in financial reporting. We believe that five years is already ample time for a publicly held company with tens of millions of dollars in revenue to develop the capacity to provide fully reliable and accurate financial statements. Ten years is excessive and the Committee should reject H.R. 4139.

H.R. 4166, the “Expanding Proven Financing for American Employers Act”, creates a “Qualified CLO” that would exempt many securitizations of commercial loans (Collateralized Loan Obligations, or CLOs) from new Dodd-Frank risk retention requirements. These risk retention requirements were put in place to ensure that securitization sponsors retain on their books five percent of the credit risk of all securitizations they issue. Retaining risk aligns incentives of sponsors and investors in order to encourage better underwriting and design of securitizations. Such alignment works against the negative effects of the “originate to distribute” model of securitization, which had disastrous effects during the financial crisis. With the aid of deceptive ratings from compromised ratings agencies, sponsors of complex mortgage securities passed the risk of the ‘toxic assets’ they designed on to more naïve or poorly informed investors.

The regulators’ final risk retention rule already exempts CLO securitizations from risk retention if such securitizations are limited to loans which meet strong basic underwriting standards. These underwriting standards require third party verification that a borrowing company has reasonable levels of debt relative to their income and assets. But H.R. 4166 goes far beyond the current regulatory exemption based on underwriting standards to exempt a very broad share of the existing CLO market from risk retention. For example, securitizations of “subprime” corporate loans made to companies that are already heavily indebted would be exempted; indeed H.R. 4166 eliminates almost all loan underwriting standards as a requirement for the new exemption it creates.

H.R. 4166 does include a long list of “structural protections” based on the design of the overall securitization. But these supposed protections either replicate longstanding market practices (such as overcollateralization and interest coverage tests, standard in securitizations even before the financial crisis) or are inadequate to protect against excessive leverage or poor loan quality in the CLO. For example, H.R. 4166 requires an equity share of only 8 percent, permitting a qualifying CLO to be leveraged at over twelve to one. By eliminating underwriting leverage limits in the underlying loans, this leverage is inflated still further. Making things even worse, CLO sponsors are given an out from the already inadequate asset quality protections in the bill, since Section 7(B)(i)(VIII) of the amended risk retention statute would actually permit them to be out of compliance with many of the stated structural protections in the legislation.

Even if these inadequate protections were strengthened, so long as the underwriting quality of the actual loans contained in the CLO qualifying for a risk retention exemption are not tightly controlled, then sponsors could issue very high-risk securities without retaining adequate risk.

H.R. 4166 would also reduce CLO risk retention from 5 percent of the entire securitization to 5 percent of only the 8 percent equity tranche. This reduces the risk retention requirement from 500 basis points to just 40 basis points, or $400,000 in loss risk on a $100 million dollar securitization. This hardly qualifies as true ‘risk retention’, and would not properly align incentives between the securitization sponsor and the investor.

The CLO market has grown enormously since the financial crisis and we have little experience with how the expanded CLO market will handle an economic downturn. Corporate debt markets are currently under significant stress as Federal Reserve policies and commodity prices change. It now appears that during previous years there may have been excessive liquidity and poor controls on credit quality in some of these markets. A recent JP Morgan analysis found that over half of mezzanine-level tranches of CLOs they examined were showing mark to market losses, up from less than 1 percent in September 2015.[2] It does not make sense to weaken oversight in these markets. We urge you to reject H.R. 4166.

[2] The study is cited in Grant’s Interest Rate Observer, “Trouble Times Leverage”, pp. 9-11, January 29, 2016.

H.R. 4498 , the "HALOS Act", would permit issuers of unregistered securities to be exempted from safeguards regarding general solicitations so long as such solicitations were made at an 'event' sponsored by any of a wide range of non-profit or educational organizations, investor associations, or trade associations.

SEC registration requirements are designed to protect investors by providing investors with verified, reliable financial information concerning the securities they invest in. The JOBS Act made it possible to do broad-based general solicitation of the public for the sale of riskier unregistered securities. But it also required that companies do a good-faith verification that investors were in fact accredited investors who met a range of qualifications indicating they could afford the increased risk of loss associated with investing in unregistered securities. This requirement is an important investor protection.

H.R. 4498 would eliminate this investor protection for a very wide range of types of issuer events, events that could easily be used to solicit investment from the broader public, including many who are not accredited investors. This exemption is overly broad and would likely lead to losses for investors who are not prepared to take the significant risks associated with purchases of unregistered securities.

H.R. 4620, the "Preserving Access to CRE Capital Act", would exempt many securitizations of commercial real estate (CRE) loans from new Dodd-Frank risk retention requirements. As discussed above, these risk retention requirements are a crucial new regulatory protection designed to align incentives between sponsors of complex securitizations and investors who purchase them. Inadequate protections in the securitization markets were a crucial cause of the 2008 financial crisis, which heavily impacted the commercial real estate market. The market for new issuance of commercial mortgage backed securities (CMBS) essentially shut down for an extended period of time during the 2008-2010 period, and CMBS received extensive government support from government programs such as the Federal Reserve's Term Asset Lending Facility (TALF).

Regulators have already incorporated significant underwriting-based exemptions to these risk retention requirements for commercial real estate securitizations. Securitizations would be exempted from risk retention requirements if they are limited to CRE loans which meet good underwriting standards based on the expected cash flow and valuation of the underlying property relative to the debt taken on.

H.R. 4620 would enormously increase the scope of this exemption for securitizations backed by commercial real estate loans, effectively eliminating risk retention requirements for loan securitizations that do not meet strict underwriting standards.

For example, H.R. 4620 would exempt interest-only loans from risk retention requirements, prohibit regulators from addressing issues with the length of loan amortization schedules, and apparently mandates that regulators could not adjust loan to value caps for commercial loans based on the estimated cash flow from the property. The legislation also provides a blanket exemption for all 'single loan' securitizations, broadly defined as securitizations collateralized by a loan or related group of loans on commercial properties that are under common ownership or control. While such securitizations may be somewhat more transparent to investors in some cases, they also lack diversification benefits and certainly may be poorly underwritten, just as any other loans may be.

H.R. 4620 would prevent risk retention standards from being appropriately applied to the CMBS market, and should be rejected.

H.R. 4638, the "Main Street Growth Act", would permit the creation of SEC-registered 'venture exchanges' for trading ownership shares of early stage startup companies with valuations of up to $2 billion. Despite the fact that these exchanges would carry the implicit reputational benefits of SEC registration, they would be exempted from a wide variety of SEC regulations governing exchange conduct, and the 'venture securities' traded on such exchanges would be given a blanket exemption from state anti-fraud laws.

The startup companies to be traded on these exchanges generally lack a track record of well documented financial performance for outside investors. This creates a situation ripe for fraud, especially given numerous exemptions granted in this legislation.

Currently, there are also substantial and well justified concerns regarding the valuation of even more reputable venture capital startups. Valuations dropped off sharply at the close of 2015 and some 90 percent of venture capital partners responding to a recent survey expected further declines in 2016.[3] Due to the lack of any clear track record on startup company finances, insiders to these companies, including venture capital firms that have made early stage investments and top company management who have ownership shares, are likely to have enormous informational advantages over outside investors in pricing the company. We are deeply concerned that any "venture exchange" could be used as a mechanism for insiders of overvalued startup companies to sell ownership shares to less well informed outsiders at greatly inflated prices.

The question of whether a trading venue for shares in early stage startup companies can be effective without greatly increasing risks of investor fraud and abuse is a complex one and requires further study, including study of what investor protections would be required. Such exchanges are likely to require more investor protections, not less, than conventional exchanges in order to prevent fraud and abuse. But H.R. makes it simple to create these untested "venture exchanges" and greatly reduces investor protections on such exchanges as compared to exchanges trading conventional public company shares. This is exactly the wrong approach and H.R. 4638 should be rejected.

Thank you for your consideration. For more information please contact AFR's Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

[3] Suster, Mark, "Venture Capital 2016: Some Upfront Views", Upfront Ventures, February 2, 2016. Available at http://www.slideshare.net/msuster/upfront-vc-analysis-2016

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America

- Greenlining Institute
- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council

- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer’s for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG

- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX

- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida

- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET