215 Pennsylvania Avenue, SE • Washington, D.C. 20003 • 202/546-4996 • www.citizen.org

June 6, 2017

Honorable Member
United States House of Representatives

RE: Oppose the Financial CHOICE Act

Dear Honorable Member,

On behalf of more than 400,000 members and supporters of Public Citizen, we offer the following comments on Chair Jeb Hensarling's Financial CHOICE Act. This measure is a 593-page license for the financial sector to endanger the system and abuse consumers. Not only does it eliminate many of the reforms Congress adopted to respond to the Wall Street crash of 2008, it would render financial policing agencies even weaker than before this calamity.

It eliminates the Volcker Rule prohibition on using taxpayer-backed funds for speculation. It eliminates most of the reforms on banker pay, ignoring the glaring compensation incentives for excessive risk-taking.

The bill hobbles the new Consumer Financial Protection Bureau. It removes its powers to enable consumers to use the courts when scammed by predatory lenders, instead allowing firms to force them into unworkable, mandatory arbitration.

The bill also sprawls into the securities markets with measures that reduce safeguards for investors when firms attempt to raise capital. Shareholder rights to bring resolutions before annual meetings are stripped, as is the ability of shareholders to nominate directors that would be listed on the ballot with company-proposed directors.

Chair Hensarling does include one modest step forward in the bill. He includes a provision which would require greater bank capital requirements for the largest institutions. Whereas the bill envisions assets greater than liabilities of 10 percent, some of the losses reported by the Federal Reserve leading to the financial crash approached 20 percent of assets. This argues for a leverage ratio of 20 percent.

This bill is divorced from reality. It is a fact that the financial crisis caused enormous harm, draining more than $12 trillion from the economy, where millions lost their homes, the jobs and their savings. [1] This tragedy demanded reform. It is also a fact that since passage and then partial implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the economy has mainly recovered. Unemployment is half its post-crash peak, and loan-making has recovered.[2] The CHOICE Act claims that neither fact is true.

There are more than 200 provisions in this massive bill that Public Citizen opposes. To list these provisions is essentially to reprint the sections of the bill. What follows are simply a few of the more dangerous provisions, not an exclusive listing of our concerns.

Systemic Risk and "Too Big to Fail"

Following the Lehman bankruptcy on September 15, 2008, credit markets froze as this interconnected firm ceased its payments to a sprawling network of creditors. Washington reversed course with the other failing financial institutions and bailed them out so they could meet their debt payments, as the institutions were considered "too big to fail" (TBTF). The 2010 Wall Street Reform Act was an initial attempt to mitigate TBTF, both when firms become insolvent, and ideally, to reduce the practices that lead to insolvency. The CHOICE Act irresponsibly eliminates many of these safeguards.

Section 151 of the bill prohibits the Financial Stability Oversight Council from designating any non-bank financial institution as systemically important. The biggest bailout went to AIG, an insurance company, following the firm's unmonitored issuance of bond insurance known as credit default swaps. Violating the first maxim of insurance, the purchasers of these swaps need not own the underlying bond, meaning that the failure of one bond could trigger payments many times the size of the bond. This section also eliminates the Office of Financial Research, a team that specifically looks at potential problems such as AIG that are not daily supervised by federal agencies.

Section 111 eliminates the Federal Deposit Insurance Corp.'s ability to address a major failure through what's known as "orderly liquidation authority." The Lehman bankruptcy demonstrated that a court could not efficiently and expertly prevent contagious damage to other firms. Instead, orderly liquidation provides a means for experienced bank specialists to sustain the core functions of credit-making while the institution is resolved.

Section 901 repeals the Volcker Rule, the important provision which limits the ability of banks to use taxpayer-backed deposits for speculation. Some of the largest losses during the financial crash took place in what's called the "trading book," which is where securities are held. According to

[1] United States Government Accountability Office, "Financial Regulatory Reform: Financial Crisis Losses and The Potential Impact of the Dodd-Frank Act", GAO 13-180, January, 2013.
Luttrell, David, Tyler Atkinson and Harvey Rosenblum, "How Bad Was It? The Costs and Consequences of the 2007-2009 Financial Crisis and Its Aftermath", Federal Reserve Bank of Dallas Staff Paper No, 20, July, 2013.
[2] Kate Berry, *Four myths in the battle over Dodd-Frank,* AMERICAN BANKER (March 10, 2017) https://www.americanbanker.com/news/four-myths-in-the-battle-over-dodd-frank.

Basel Committee on Banking Supervision, "Since the financial crisis began in mid-2007, the majority of losses and most of the build-up of leverage occurred in the trading book. Losses in many banks' trading books during the financial crisis have been significantly higher than the minimum capital requirements."[3] Many assets were connected to bad loans packaged in securities such as collateralized debt obligations. Even after the crash, JP Morgan reported a $6 billion loss from speculation in derivatives. Instead of repealing it, the Volcker Rule should be improved by eliminating market-making as a permission for federally insured banks and their affiliates.

Section 857 contains 40 separate repeals of Wall Street Reform provisions, many of which are intended to address out-of-control banker compensation. Even as taxpayers bailed out banks, bankers collected substantial bonuses. One reason that Wall Street crashed the economy are the misplaced incentives that meant excessive risk-taking could lead to increases in personal fortune; and the inevitable losses were not balanced by personal loss. The 10 senior executives of Bear Stearns and Lehman Brothers were paid a collective $1.4 billion in eight the years leading to the crash (2000-2008). That's an average of $140 million each.[4] Among the provisions repealed is an important directive that compensation be restructured so that it does not motivate "inappropriate risk-taking." Also repealed is a provision that requires that compensation hedging be disclosed. Hedging defeats the role of bonuses, which are supposed to be based on performance. Also repealed is a simple disclosure of the CEO's pay as a multiple of the median-paid employee. This measure can help investors understand better if CEO pay is excessive and may contribute to employee demoralization and loss of productivity. Section 849 sharply reduces the claw back provisions meaning that even senior Wells Fargo officers would not face compulsory claw backs.

Regulatory hurdles

In addition to eviscerating Wall Street reform, the CHOICE Act would disable regulatory response to evolving problems, leaving the public even more vulnerable to financial mayhem than before the financial crash of 2008.

Title III establishes new, unworkable rules that will stifle oversight and rulemaking. First, subtitle A of Title III contains new analytic requirements a financial regulatory agency must complete before any rulemaking, any one of which could be material for a lawsuit by Wall Street interests seeking to block new rules. Then, Subtitle B requires an affirmative vote by both houses of Congress of any significant new financial regulation. Where Congress fails to act, which has been the norm in the last 6 years, there could be no new rules. Subtitle C overturns Supreme Court precedents whereby courts defer to experts in regulatory agencies when deciding anti-regulation lawsuits. Instead, courts would be required to judge "de novo" claims involving the justification for and technical details of the regulation, reversing the precedent of more than three decades under the *Chevron* doctrine. This means that in any lawsuit claiming that a regulatory action was unjustified, the judge would be encouraged to substitute his or her views for that of the regulatory agency's expertise.

[3] *Reducing procyclicality arising from the bank capital framework*, JOINT FSF-BCBS WORKING GROUP ON BANK CAPITAL ISSUES (2009)

[4] Bebchuk, L., Cohen, A., Spamann*, H. The Wages of Failure: Executive Compensation at Bear Stearns and Lehman* 2000–2008. YALE JOURNAL ON REGULATION 27, 257–282

Finally, Subtitle E politicizes financial supervision by making the budgets of the FDIC, the Comptroller of the Currency, and the Federal Reserve (except monetary policy functions) subject to congressional appropriations. This paves the way for financial firms with influence in the legislative process to interfere with what should be impartial supervision and rule-making. The Securities and Exchange Commission is already subject to such appropriations, which is one reason that the agency has failed to complete mandatory rule-making and ignored petitions for other important reforms, such as the investor demanded rulemaking to require corporate disclosure of their political spending.

Consumer Protection

Reckless, often predatory mortgage loan-making led to a housing bubble whose rupture caused the great recession. When housing prices fell, many borrowers found themselves “underwater,” with mortgage obligations greater than the value of their homes. In response to this and other abuses, Congress created the Consumer Financial Protection Bureau (CFPB). Unlike the banking agencies, which guard the soundness (often measured as profitability) of the banks, the CFPB was designed to focus exclusively on financial firm treatment of consumers. To date, that’s led to some $12 billion in restitution for more than 28 million customers.

Title VII appears to be designed by the very industry that the CFPB polices. Under Section 711, the President could remove the director at will. Currently, the director can only be removed for malfeasance, misconduct or neglect of duty. The current president, who has not divested his many business interests, is highly dependent on credit. This provision would allow the president to provide relief to favored lenders.

This title further subjects the CFPB budget to the appropriations process, subjecting its policies to congressional politicization.

Section 738 prohibits the CFPB from restricting mandatory arbitration. Many consumer contracts contain clauses that prohibit a customer who discovers an unlawful charge from joining with other, similarly aggrieved citizens to file in court. Instead, they must submit to arbitration, an absurd option especially where the claim may be smaller than the arbitration fee. Mandatory arbitration serves as an invitation for firms to abuse customers because there is no real recourse.

Section 736 repeals the ability of the CFPB to address practices that it finds unfair, deceptive or abusive.

Section 733 eliminates the CFPB’s ability to oversee payday lending, one of the most abusive arenas, where many borrowers find themselves in a debt trap with unconscionable interest rate payment obligations.

Section 735 repeals limits on debit card fees charged by banks with more than $10 billion in assets. The law requires the fee to be limited to the reasonable cost of the transaction. Repeal of this regulation would allow the nation’s largest banks to charge retailers and customers an additional

$6 – $8 billion per year in card fees. The current law followed a careful study by the Federal Reserve.

Section 725 eliminates the popular consumer complaint data base. This data base has allowed consumers both to register complaints, allowing the CFPB to respond to specific problems, and also lets consumers educate themselves about problem service providers.

Securities Markets

Beyond gutting Wall Street reform, the bill cuts safeguards in other arenas.

Section 841 effectively nullifies a new rule from the Department of Labor (DOL) that requires Wall Street agents to put their client interests ahead of their own interest in commissions. Unsuspecting customers are often steered into inferior investment products that pay the broker more. The Hensarling measure requires that any DOL rule must be substantially similar to one adopted by the Securities and Exchange Commission (SEC). The SEC hasn't acted on the issue.

Section 844 effectively eliminates the ability of average shareholders of publicly traded companies to submit resolutions for a vote at annual meetings. These resolutions have led to important reforms over the years, such as requiring the chair of the board to be someone other than the CEO. The Hensarling bill would require shareholders to hold 1% of the company in order to submit a resolution. At JP Morgan, this would require a holding of more than $2 billion.

Section 857 also prohibits the SEC from adopting a rule whereby shareholders could nominate director for corporate boards that would appear on the ballot. Perhaps one of the most glaring problems in corporate governance is the fact that boards are insulated, and there are only as many candidates as there are board seats. Even though many large corporations have as much influence on the nation as a city, there are no true elections for these boards, even for their shareholders.

Even as the proposal terminates many shareholder rights, it proposes to expand the powers of business to raise funds in the capital markets with fewer investor safeguards.

Subtitle P undercuts the basic investor safeguards in crowdfunding. By nature, sophisticated, institutional investors can only justify their research expense if the resulting investment is of sufficient size. Less sophisticated investors often rely on the resulting prices that these market professionals help to determine. In crowdfunding, however, the offerings by nature will not attract such sophisticated investors. That's because they are too small. That leaves only smaller and often unsophisticated investors. To guard against scam artists exploiting this market, the current law and the SEC limit the amount an individual can invest, limit the amount that can be raised, require a registered intermediary to host the crowdfunding, and provide liability for misstatements. Subtitle P eliminates all of these protections.

Section 827 would allow unscrupulous promoters to use the private placement vehicle of Regulation D and Rule 506 exemption. It repeals Dodd Frank Section 926, which disqualifies promoters who have been convicted of a felony, or misdemeanor, or were the subject of an administrative order, which is the SEC definition of "bad actor."

Compounding this problem, Section 466 prevents the SEC from requiring these private placement issuers from filing the simple Form D notice before it engages in public advertising, known as "general solicitation." Public Citizen opposed this general solicitation law, given that an investor who does know enough to call a broker if interested in investing should not be subject to clever advertising. But Section 466 also nullifies the promoter from issuing Form D, which is simply the identity of the business, address, type of business, and names of officers. Given that this is a $1 trillion business, the legitimate market could be undermined if it swells with unscrupulous securities purveyors.

Section 847 allows firms with as much as $500 million worth of shareholder capital to escape basic financial accountability provided under the Sarbanes-Oxley Act of 2002, such as the CEO attestation that the books are sound. Section 421 lets firms that are selling securities to promote the stock in the guise of investment research. This harkens to the days of the "dot.com" bubble when investment firms knowingly promoted internet firms in so-called analyst reports that the analyst privately believed where unworthy. Section 452 allows private placement investments that should only be advertised to sophisticated investors to be marketed at non-profit organizations, including places of worship.

Conclusion

America deserves true Wall Street reform. Public Citizen has outlined a blueprint to address the TBTF problem in our publication *Too Big*.[5] We believe that real capital standards, where a major bank's assets are 20 percent greater than liabilities, are sorely needed. We also believe that the Glass-Steagall separation of commercial and investment banking should be restored. And we believe the largest banks should be broken up.

Consumers deserve protection from predatory lenders. Investors need protection from unscrupulous Wall Street brokers.

The CHOICE act is a profoundly cynical exercise that will only please Wall Street, not Main Street, the greater economy, and the nation.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org, or 202.580.5626

Sincerely,

Public Citizen

[5] Bartlett Naylor, *TOO Big*, PUBLIC CITIZEN (June 2016) http://www.citizen.org/documents/TooBig.pdf