AFR Americans for Financial Reform

October 11, 2017

Dear Representative:

On behalf of Americans for Financial Reform, we are writing to urge you to reject the irresponsibly deregulatory bills under consideration at today's hearing.[1]

Today's markup is a gift basket for Wall Street and for major financial institutions across the country. In light of the lessons of the 2008 financial crisis, the regulatory weaknesses revealed by the more recent scandals at Wells Fargo and Equifax, and the need to protect ordinary families affected by historic natural disasters across the country, it is shocking that the Financial Services Committee is instead devoting it's time to marking up a long industry wish list of deregulatory legislation. While banks show record earnings, capital markets set new records for debt issuance, and stock markets reach new heights, there is simply no public interest reason for these bills. Indeed, their central rationale – that protections against financial abuse and recklessness have damaged the financial system – has been shown to be false.

Below, we have laid out specific objections to nineteen of the bills being marked up by the Committee this week. Not all of this legislation would be equally damaging. Some, such as HR 1116 (the TAILOR Act), would have disastrous impacts across a wide range of financial regulation, while others, such as HR 477, would have more limited effect. However, we urge the members of the Committee to oppose all 19 bills discussed below. All of them are unjustified and overbroad actions that would significantly hamper regulatory oversight of critical areas of our financial markets, making them less safe or less fair for consumers, for investors and for all of us.

CONCERNS ABOUT SPECIFIC BILLS

We address the 19 bills we oppose in numerical order below.

HR 477, the "Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017": This legislation would eliminate SEC broker-dealer registration requirements for merger and acquisition (M&A) brokers. The bill has been improved from previous versions that did not include protections against bad actors or the use of shell companies to engage in disguised private equity transactions. However, the bill is still fundamentally unnecessary, as the SEC has already taken administrative action to exempt merger and acquisition brokers from broker-dealer registration, while preserving its capacity to enforce needed investor protections.[2] It is also far too broad, exempting any acquisition of a company with gross revenues of $250

[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 AFR members is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] Securities and Exchange Commission, "No-Action Letter Re M&A Brokers", January 31, 2014 [Revised February 4, 2014]. http://bit.ly/2g1ehLg

million or less – far exceeding the size of local small businesses that use ordinary M&A brokers. Any potential application to private equity is concerning, as the exemption from broker-dealer registration would restrict the SEC in policing private equity and interfere with ongoing SEC investigation of potential abuses involving unregistered broker-dealer activities.[3]

HR 1116, the "Taking Account of Institutions with Low Operation Risk Act of 2017": This legislation purports to assure that Federal banking regulators 'tailor' regulations to the risk profile and business model of regulated institutions. However, this requirement is unnecessary, as regulators are already scaling rules to the size and business model of financial institutions. Instead, the major impact of the bureaucratic procedures mandated in this bill would be to serve as a barrier to regulatory action even in cases where it was clearly needed, and to provide yet another path for regulated entities to overturn rules in court.

HR 1116 requires that regulations be tailored "in a manner that limits the regulatory compliance impact, cost, liability risk, and other burdens". This mandate would force regulators to prioritize the costs of regulations to financial institutions over the offsetting benefits to consumers and the general public. This implies that they would be unable to act to protect the public if such action led to any significant costs to Wall Street banks. Regulators would be required to apply this deregulatory mandate retroactively to all previously passed Dodd-Frank rules, and in the future to any new rules being considered. Another effect of the retroactive and future application of the vague and sweeping mandates in this legislation would be to encourage a flood of litigation seeking to reverse financial protections.

HR 1585, "To amend the Securities Act of 1933 to codify certain qualifications of individuals as accredited investors for purposes of the securities laws": It is not unreasonable to add licensed subject matter experts to the list of those who qualify as accredited investors, as HR 1585 does. However, the bill also places in statute a definition of accredited investor based on an outdated set of financial thresholds, blocking off more thoughtful efforts to update and improve the definition through rulemaking.[4] We favor leaving this issue to SEC rulemaking rather than enshrining financial thresholds in law.

HR 1645, the "Fostering Innovation Act of 2017": This legislation would double the time for which certain new public companies are exempt from key financial reporting controls, most notably attestation by an auditor that their earnings and accounting are accurate. It grants this exemption to a class of companies, newly public companies with low revenue growth, which have a particular strong incentive to manipulate their financial statements and deceive investors. This bill would both harm investors and undermine the integrity of our capital markets.

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[3] Buccacio, Katherine, "Republicans Look to Ease PE Regulatory Burden", Private Equity Manager, January 13, 2015; Morgenson, Gretchen, "Private Equity's Free Pass", New York Times, September 27, 2014.
[4] See for example the proposal by the SEC Investor Advisory Committee, available at http://bit.ly/22HoUHw

HR 1699, the "Preserving Access to Manufactured Housing Act of 2017": This bill would exempt manufactured housing lenders from requirements that protect their customers against inappropriately high-cost loans. It also exempts manufactured-home retailers from the definition of mortgage originators and from compliance with the corresponding borrower protections. This exemption would raise costs to manufactured-home buyers and permit them to be steered into abusive high-cost loans. Loans for purchasing manufactured homes are generally made to lower income people, and there is a record of both past and recent abuses in this market, making this push to remove protections particularly unwise.

HR 2121, the "Pension, Endowment, and Mutual Fund Access to Banking Act": This legislation would exempt large custodial banks from holding mandated equity capital against potential losses in custodial funds they have deposited with the Federal Reserve. This provision would mainly benefit BNY Mellon and State Street, the two custody banks large enough to be subject to the Supplementary Leverage Ratio (SLR), which requires the largest systemically significant banks to hold 5% equity funding against their balance sheets to protect from financial risks. Some limited exemptions from leverage rules for custodial funds may be appropriate. But it is dangerous to undermine the leverage ratio, which is a crucial backstop to ensure that the largest banks hold a minimal level of equity capital against potential losses that are not predicted by regulatory risk models. The vital importance of strong equity capital holdings by the largest banks make this issue more suited to regulatory than statutory treatment. The Federal Reserve Board has already signaled that it will take regulatory action on the issue.

HR 2148, the "Clarifying Commercial Real Estate Loans Act": This legislation would relax capital standards for certain commercial real estate loans by creating significant new exemptions to current regulatory classifications as a high-risk commercial real estate loan (or HVCRE), a class of loan which requires additional capital backing from a bank to protect against losses. Congressional intervention to loosen risk controls on high-risk commercial real estate is not called for in the current economic environment. Commercial real estate lending has been growing very rapidly in recent years and indeed regulators are concerned about potentially significant risks to banks that might result if economic growth slows.[5] In addition, regulators are already acting to simplify and make more manageable the HCVRE rules targeted by this legislation.[6] The bill should be rejected.

HR 2201, the "Micro Offering Safe Harbor Act": This legislation would exempt so-called "micro-cap offerings" (offerings valued at $500,000 or less in a single year) from core regulatory protections in the 1933 Securities Act, including registration, disclosure, and fraud protections.

[5] Fessenden, Helen and Catherine Meuthing, "Understanding the Surge In Commercial Real Estate Lending", Economic Brief EB 17-08, Federal Reserve Bank of Richmond, August, 2017. http://bit.ly/2xxClAE
[6] Federal Deposit Insurance Commission, "Simplifications to the Capital Rule Pursuant to EGRPPRA", FIL 45-2017, September 27, 2017. http://bit.ly/2yEFZc7

The legislation would permit such securities to be sold to unsophisticated and/or lower income investors, and requires only that such investors have an unspecified "pre-existing relationship" with an officer, director or major shareholder of the issuer. The bill requires no notification to regulators, no disclosures, and no restrictions on secondary sales. It also pre-empts state regulatory authority, raising the possibility that there will be no meaningful regulatory oversight of these offerings. This exemption would be an open invitation to affinity fraud in the sale of securities.

HR 2396, the "Privacy Notification Technical Clarification Act": The current text of the bill appears to be much more than a technical correction. It would create major exemptions from annual notice requirements to provide clear and conspicuous notice to consumers that they are able to opt-out from having their personal information shared and sold to unaffiliated third-party companies, The Consumer Financial Protection Bureau currently does not permit financial companies to avoid these annual notice requirements in cases where they share customer information with unaffiliated third parties. But if this bill became law expanded exemptions would make these requirements meaningless.

HR 2706, the "Financial Institution Customer Protection Act of 2017": This legislation would hamper the efforts of banking regulators to advise financial institutions of warning signs that their customers are engaging in fraud or other illegal activity, putting consumers and financial institutions at risk of serious financial loss. *This bill is more harmful now than ever in light of the critical importance of blocking access to the payment system by criminals who may use information from the Equifax and other data breaches.*

The provisions in HR 2706 do not merely apply to direct orders from a federal banking agency to close a bank account – which is something that rarely if ever happens. This legislation would also trigger onerous procedures in simple cases of informal requests or warnings, or any action taken to "restrict or discourage a depository institution from entering into or maintaining a banking relationship with a specific customer or group of customers." This vague and broad trigger could apply any time a regulator warns financial institutions of the signs of potential illegal or fraudulent activity, even if it relates to criminals as a group as opposed to a single customer. The bill would impose new, burdensome requirements before an agency could warn a financial institution about red flags of fraudulent or criminal conduct, whether the warning relates to a particular customer or criminals as a group.

HR 2954, the "Home Mortgage Disclosure Adjustment Act": This bill would exempt numerous banks and non-banks from reporting information about the mortgages and home equity lines of credit (HELOCs) they are originating. The Consumer Financial Protection Bureau has estimated that the 500 transactions reporting threshold on mortgages included in this bill would exempt 85 percent of depositories (5,400 banks) and 48 percent of non-depositories (497 non-depository institutions) from having to report pursuant to the agency's final rule under the Home Mortgage Disclosure Act (HMDA). Thousands of communities across the country rely on

HMDA information to understand potential predatory lending patterns and racial discrimination in lending. The 25-loan threshold already set by the CFPB in its rules already exempts 22 percent of banks from mortgage disclosure rules.

HR 3072, the "Bureau of Consumer Financial Protection Examination and Reporting Threshold Act of 2017": This bill would end the CFPB's supervision of and enforcement authority over banks and credit unions with $10 billion to $50 billion in assets, reducing the number of depository institutions examined by the CFPB from 119 to 42. This would disperse key consumer protection authority for these institutions to the other agencies that failed to use it effectively in the past, and undo the advances in consumer protection that focused effort by the CFPB has made possible. It would also restore opportunities for firms to play one regulator off against another.

Some of the largest bank failures in the financial crisis were caused by poor consumer protection supervision of banks in the size range affected by this bill.. IndyMac failed with $30.6 billion in assets as a result of risky mortgage lending, costing the Deposit Insurance Fund more than $12 billion -- the largest loss in history. Poorly underwritten mortgage loans were also a principal cause in the failure of other institutions with $10 billion to $50 billion in assets, including BankUnited ($13.1 billion in assets), Downey ($12.7 billion), and AmTrust ($11.4 billion). Banks over $10 billion are among the largest 2 percent of banks in the country and do not need special carve-outs. HR 3072 should be rejected and the CFPB should maintain supervisory and enforcement authority over all banks with $10 billion or more in assets.

HR 3299, the "Protecting Consumers' Access to Credit Act of 2017": This bill would override the Second Circuit's *Madden v. Midland* decision, which held that a debt buyer purchasing debts originated by a national bank could not benefit from the National Bank Act's preemption of state interest rate caps. The *Madden* decision did not limit the interest rates that banks may charge on credit cards and other forms of credit. But it does limit nonbanks from evading state caps on excessive (usurious) rates of interest. Reversing the Second Circuit's decision, as this bill would do, would make it far easier for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use "rent-a-bank" arrangements to charge high rates on loans.

This bill could open the floodgates for a wide range of predatory actors to make loans at 300% annual interest or higher, simply by partnering with a bank which could transfer such usurious loans to them. In a letter by 20 State Attorneys General opposing provisions in another bill that would have overturned the Madden decision, the state law enforcement officers warned that the bill "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps."[7] Congress should attend to the warning of state law enforcement officers and reject this bill.

HR 3312, the "Systemic Risk Designation Improvement Act of 2017": HR 3312 would severely restrict Federal Reserve oversight of 27 large bank holding companies (BHCs), which each hold over $50 billion in assets but are not one of the eight largest U.S. banks with global operations. These banks, while smaller than the very largest Wall Street mega-banks, are well within the largest one percent of the 5,800 insured banks in the U.S. – enormously larger than community banks. Collectively, they hold over $4 trillion in assets, around a quarter of all banking system assets.

Large regional banks of a similar size to those affected by this bill played a major role in the 2008 financial crisis. H.R. 3312 would eliminate the Congressional mandate to strengthen rules for large regional banks. It would also drastically weaken Federal Reserve oversight authority by effectively eliminating the Federal Reserve's discretionary authority over large banks in cases where such banks had not been determined to be individually critical to the entire U.S. financial system. The legislation mandates that enhanced prudential oversight would apply to only the eight largest banks in the U.S., thus eliminating enhanced prudential standards for over two dozen of the nation's largest banks. If the Federal Reserve wished to apply enhanced prudential standards to large regional banks it would be subject to a complicated set of hurdles that would be difficult if not impossible to meet.[8]

These restrictions represent major new limitations on the capacity of the Federal Reserve to make basic decisions on bank safety and soundness. For many decades, well before the 2008 financial crisis, bank supervisors have had clear discretionary authority to take action to address risks at major bank holding companies. HR 3312 would for the first time place major restrictions on this authority as it applies to core safety and soundness protections such as capital requirements, stress testing, credit exposure limits, and more. This legislation goes beyond reversing Dodd-Frank and weakens regulatory authority even compared to the period before the 2008 financial crisis.

HR 3857, the Protecting Advice for Small Savers Act of 2017": This bill would repeal the Department of Labor (DOL) conflict of interest (or "fiduciary) rule. Repealing the rule would restore huge loopholes in retirement savings protections that make it easy for salesmen who present themselves as "advisers" to avoid legal obligations to put the best interests of their

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[7] Letter from Eric T. Schneiderman, New York Attorney General, to Paul Ryan, Speaker, U.S. House of Representatives, et. al. (June 7, 2017), *available at* https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf

[8] Under HR 3312, to apply prudential standards to any but the top 8 banks in the country, the Federal Reserve would have to either gain approval by a two-thirds majority of the Financial Stability Oversight Council (FSOC), or else demonstrate that this individual bank posed a risk to the stability of the entire U.S. financial system.

customers first. In the absence of these protections, sellers of financial products can steer customers to investment products that pay benefits to the seller at the expense of the retirement savings of working families. Indeed, in an extensive economic analysis upheld in multiple court decisions, the Department of Labor has demonstrated that ordinary savers lose tens of billions of dollars a year to these conflicts of interest.[9]

In place of true fiduciary protections, HR 3857 would substitute a watered down standard that relies on simple disclosure of conflicts of interest rather than true limitations on irresponsible behavior by brokers. It is not clear that the bill's so-called "best interest" standard provides protections that are any stronger than those afforded by today's "suitability" standard that currently applies to brokers' non-retirement account recommendations. It does not include any meaningful restrictions on the toxic conflicts of interest that currently pervade the broker-dealer and insurance agent business models. HR 3857 should be rejected and the true best interest standard in the Department of Labor's regulation should be implemented.

HR 3911, the "Risk-Based Credit Examination Act": This legislation would severely weaken regulations of the large credit rating agencies such as Standard and Poor and Moodys that are essential gatekeepers in the securities markets. These rating agencies were major contributors to the financial crisis of 2008. They certified tens of thousands of "toxic" securities based on subprime mortgages as high-quality, investment grade assets that were safe to hold for investors and banks. The failure of the credit rating agencies to do their job of properly assessing securities risk was rooted in the conflicted incentives they face. Since they are paid by securities issuers, their incentives are to give high ratings that will help the issuers sell their product easily.

The Dodd-Frank Financial Reform Act required the Securities and Exchange Commission (SEC) to annually examine ratings agency practices to attempt to ensure that ratings were carried out with integrity and that conflicts of interest did not again have a disastrous impact on rating agency performance. By substituting the words "as appropriate" into the mandate to annually examine these credit rating agencies, HR 3911 would eliminate the mandatory examinations required by the Dodd-Frank Act and instead substitute examinations that would be optional for the SEC. It would also open the door for credit rating agencies to sue the SEC if they felt examinations were stronger than implied by the "as appropriate" language. The precedent of the interpretation of "as appropriate" in the case of commodity position limits shows that courts can and will interpret this language to require extensive cost-benefit justification of regulatory actions.[10] If HR 3911 passed, even if the SEC was willing to aggressively carry out examinations of ratings agencies, it would be subject to court challenge. Large ratings agencies crashed the economy once due to their conflicts of interest. Congress should not weaken the already questionable oversight of these entities by passing this legislation,

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[9] United States Department of Labor, "Regulating Advice Markets: Definition of the Term 'Fiduciary' and Conflicts of Interest, Regulatory Impact Analysis", April, 2016. http://bit.ly/2mT9Gfq
[10] https://secure.fia.org/downloads/USDC-DC_Position-Limits-Rule-Injunction_092812.pdf

HR 3948, the "Protection of Source Code Act": This legislation would severely restrict the ability of the Securities and Exchange Commission to examine the detailed trading strategies of high-frequency traders or automated traders, even in cases where such traders posed a risk to markets or the financial system. HR 3948 would prevent regulators from routine examination not only of the raw source code used in automated trading, but even of any related intellectual property that "forms the basis for the design of or provides insight into" source code. Examination of such intellectual property would only be possible in an enforcement context pursuant to a subpoena, which implies that the SEC would have to wait until the damage was done through a "flash crash" or similar market disruption before taking action.

In light of the significance of automated trading to modern markets, and the potential risks of high frequency trading, it makes no sense to tie the hands of regulators in examining detailed trading strategies and methods of high frequency traders. At any brokerage, trading instructions to a human trader, including the conditions under which such a trade would be carried out (e.g. a limit order) would be part of the books and records routinely be open to inspection by FINRA or the SEC. Trading instructions must not be exempt from inspection simply because they are automated. They should be part of the books and records of the organization, just as other order-related documents are. Intellectual property related to source code can equally be viewed as an investment or trading strategy, which have always been a subject for regulatory inspection and oversight. While the SEC must protect sensitive intellectual property, including trading source code, it must also be permitted to examine crucial market actors and gain insight into their trading strategies. HR 3948 should be rejected.

HR 3971, the "Community Institution Mortgage Relief Act of 2017": This legislation would exempt banks with $25 billion or less in assets – over 98% of banks in the US – from consumer protection requirements related to establishing escrow accounts tied to mortgages. Such accounts ensure that consumers have funds for reoccurring homeownership-related expenses, such as property taxes and insurance premiums. Such accounts are important in avoiding mortgage default, helping consumers protect their home from the possibility of foreclosure that occurs when costs related to homeownership are not paid. While the Consumer Financial Protection Bureau (CFPB) has permitted limited exemptions to this rule for small rural lenders, HR 3971 would vastly expand this exemption to cover over 98% of banks in the country. This bill would also greatly expand the CFPB's current tailored exemption from key requirements for responsible mortgage servicing, to cover many large banks and non-banks. These important consumer protections should not be weakened as HR 3971 proposes to do.

HR 3973, the "Market Data Protection Act of 2017": This legislation would prevent the Securities and Exchange Commission (SEC) from accepting new records of market trading data for the Consolidated Audit Trail (CAT) until comprehensive risk controls were put in place by the SEC, national securities associations, and CAT operators. Bringing CAT data collection to a complete halt would cripple the development of this critical mechanism for trading market oversight and the detection of predatory and illegal trading. While we believe that the SEC and other entities should continue to develop and improve risk controls, the statutory requirement that CAT operation must cease until "comprehensive" controls are put in place is far too sweeping. Placing this requirement in statute would also prevent those who wish to continue trading in the dark and with limited oversight to sue in order to prevent the implementation of the CAT on the pretext that risk controls are not adequately "comprehensive". HR 3973 should be rejected in its current form.

We urge you to take a stand against irresponsible financial deregulation and reject the legislation described above. Thank you for your attention to this letter.

Sincerely,

Americans for Financial Reform