AFR Americans for Financial Reform

November 13, 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 tomorrow's markup.[1]

The November 14th markup is once again a gift basket for Wall Street and for major financial institutions across the country. And once again, the majority is rushing dozens of deregulatory bills through the process in a manner that ensures time and resources are not adequate for full consideration of the legislation.

This unseemly rush to deregulate has no grounding in the reality of the economic problems that face our country. With banks showing record earnings, capital markets setting new records for debt issuance, and stock markets reaching new heights, there is simply no basis for the argument that excessive controls on financial activities are damaging ordinary Americans. Indeed, it is the lack of such controls have been at the root of many problems, ranging from the lasting economic damage caused by the 2008 financial crisis to more recent scandals at Wells Fargo and Equifax.

Below, we have laid out specific objections to twelve of the bills being marked up by the Committee this week.[2] Some of these bills would cause major damage to financial protections, such as HR 4292 and HR 4293 reducing bank capital requirements, HR 1153 and HR 3299 which would harm consumers, HR 4267 and HR 4279 which harm investors, and HR 4015 which would severely damage shareholder opportunities to affect corporate policy. Others, such as HR 4292, are not as immediately harmful but are still essentially unnecessary and could create additional risks. We urge you to oppose them all.

CONCERNS ABOUT SPECIFIC BILLS

We address the dozen bills in numerical order below.

HR 1153: The "Mortgage Choice Act": This bill weakens consumer protections which limit the up-front fees that lenders can attach to mortgage loans. Post-financial crisis rules cap up-front fees for a mortgage loan to three percent or less of the total mortgage if a mortgage is to qualify for Qualified Mortgage (QM) status. HR 1153 would exclude fees associated with lender-affiliated title insurance from this cap, thus permitting lenders to push higher fees on consumers. Since consumers are generally legally mandated to buy title insurance and comparison shopping is difficult, they have few avenues for avoiding these fees, and there is already evidence of

[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] In several cases, such as bills related to financial sanctions on foreign governments, conflict minerals disclosure provisions, and monetary policy, we have refrained from comment because these are not issues we normally address. In other cases we have refrained from comment because we are still examining the bills.

significant abuses in this market.[3] Lender-affiliated title insurance is an area where kickbacks and other forms of fee inflation are particularly common. Passing HR 1153 would open the door to increased exploitation of consumers through inflated title insurance fees. We urge you to reject it.

HR 3221, "The Securing Access to Affordable Mortgages Act" – HR 3221 amends the Truth in Lending Act to provide exemptions from special appraisal requirements for higher-risk, higher-price mortgages. HR 3221 increases the exemption threshold for appraisal requirements from $25,000 to $250,000 if the creditor of the loan holds the loan for not less than 3 years. HR 3221 would also exempt mortgage lenders and others involved in real estate transactions from incurring penalties for failing to report appraiser misconduct.

At the root of the last financial crisis was a breakdown of the systems of checks and balances in the housing market. In the run up to the crisis there was widespread corruption and collusion between lenders, mortgage brokers, and appraisers to deliberately inflate housing prices.[4] Objective and honest appraisals are an important protection for the integrity of the mortgage market as a whole as well as for individual borrowers. By weakening appraisal standards, and especially by removing protections against appraiser misconduct, HR 3221 would damage mortgage markets and consumer protections. It should be rejected.

HR 3299, "The Protecting Consumers Access to Credit Act" -- This bill makes it easier for payday lenders and other nonbanks to use rent-a bank arrangements to ignore state interest rate caps and victimize consumers through high-rate payday loans. The bill overrides 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 is consistent with the centuries-old rule that nonbank creditors are covered by 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 interest rate caps.

By reversing the Second Circuit's decision, the bill would make it easier for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use "rent-a-bank" arrangements to charge rates that are in excess of state usury caps. 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."[5] The Colorado Attorney General, for example, is in the midst of challenging online

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[3] U.S. Government Accountability Office, Title Insurance: Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers 53 (2007), *available at* http://www.gao.gov/new.items/d07401.pdf.
[4] Joe Eaton, "The Appraisal Bubble," *The Center for Public Integrity.* Accessed November 10, 2017. Available at http://bit.ly/2Av9mdE.
[5] 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.

lenders' use of a rent-a-bank scheme to make loans in violation of the state's usury limits.[6] This bill would thwart actions like these that seek to enforce state laws. HR 3299 must be rejected.

HR 3978, "TRID Improvement Act" -- This bill amends the TILA/RESPA Integrated Disclosure Rule (also known as TRID) to change how title insurance fees are disclosed to consumers. The CFPB carefully studied this issue in its rulemaking to determine the clearest and most accurate way to disclose these fees in light of widely varying state laws on title insurance and differences in practices by different companies.[7] Imposing a single statutory method will lead to inconsistent disclosures and increase consumer confusion. Any further refinement in title insurance disclosures can be addressed through rulemaking by the CFPB itself in consultation with stakeholders.

HR 4015, "The Corporate Governance Reform and Transparency Act" -- Proxy advisory firms provide institutional investors, including pension funds, with the research and information they need in order to exercise their voting rights as shareholders within the numerous companies they hold shares in. HR 4015 is a transparent attempt to weaken if not eliminate the independence of proxy advisory firms by subjecting them to a poorly designed and unnecessary regulatory regime. This regime would give the public corporations that are the subject of proxy advisory research privileged access to draft voting recommendations and require proxy advisory firms to employ an ombudsman to address any complaints regarding such recommendations. No such privilege is given to those advancing shareholder resolutions. HR 4015 would also mandate extensive disclosure and reporting requirements for proxy advisory methodologies. The high costs of this regulatory regime would be passed on to investors and pension funds that make use of proxy advisory services, thus increasing costs for Main Street investors.

AFR does not hesitate to support strong regulatory regimes for financial entities when these regimes are justified by the public interest. However, HR 4015 is a naked effort by powerful corporate interests to cripple the ability of independent advisory services that empower shareholders to have a stronger voice in corporate behavior. This legislation cannot be justified, as some have attempted to do, by any analogy to the regulation of credit rating agencies, as proxy advisory services do not face a fundamental conflict of interest in their business model and have not been implicated in massive fraudulent behavior that contributed directly to a global financial crisis. Any concerns about regulation of proxy advisory services can be addressed by simply requiring such services to register as investment advisors under the Investment Advisors Act. The effort in HR 4015 to eliminate the independent voice of proxy advisory services should be rejected.

HR 4247, "The Restoring Financial Market Freedom Act" – This legislation would repeal Title VIII of the Dodd-Frank Act, which creates a heightened oversight regime for critical elements of financial market infrastructure that are central to global financial markets. Eight such infrastructure firms have currently been designated, including clearinghouses and payment

[6] Colorado Moves to Dismiss Lawsuits by Banks Seeking Judgment in Online Lending Cases", LENDIT NEWS (May 1, 2017), *available at* http://www.lendit.com/news/2017/05/01/colorado-moves-dismiss-lawsuits-banksseeking-judgement-online-lending-cases.

[7] https://www.consumerfinance.gov/policy-compliance/rulemaking/final-rules/amendments-federal-mortgage-disclosure-requirements-under-truth-lending-act-regulation-z/

system firms crucial to foreign exchange, derivatives, and securities markets.[8] Proper operations and risk management at these firms are critical to trillions of dollars in financial transactions that occur on a daily basis, and failures in risk management or oversight at such firms could lead financial markets to be severely disrupted almost instantaneously. The mandatory derivatives clearing requirement in Dodd-Frank has increased the importance of derivatives clearinghouses in particular and heightened the potential systemic risk they could pose. Repealing Title VIII would significantly weaken oversight of these firms by removing safeguards and eliminating the role of the Federal Reserve in their regulation. Given their systemic significance this would be a profoundly foolish thing to do, and we urge you to reject this legislation.

HR 4263, "The Regulation A+ Improvement Act": This bill would increase by fifty percent, from $50 million to $75 million per year, the annual exemption threshold under Regulation A+ for companies to offer and sell private securities to the public with limited disclosure requirements. This is an unwarranted increase in the threshold, especially since some eighty percent of current users of the Reg A+ exemptions raise amounts under the current $50 million per year cap.[9] More fundamentally, Congress should not be undermining public securities markets by expanding the ability of larger companies to make use of private offerings. Private offerings were designed to permit very stage capital raising from sophisticated investors by small companies, but the current cap of $50 million per year in private capital raising already permits fairly large companies to take advantage of this route. Increasing the $50 million cap will only further reduce incentives for companies to enter public markets, which is harmful since public markets offer greater investor protection and liquidity. Finally, the SEC already has regulatory authority to increase the current threshold, which they examine on a biannual basis. Congress should reject HR 4263.

HR 4267, "The Small Business Credit Availability Act": This legislation increases risks to investors by greatly expanding the amount that Business Development Companies (BDCs) are permitted to borrow. Specifically, the bill would double BDC leverage limits from the current 1-1 level (one dollar of borrowed money for each dollar of investor equity) to 2-1. In contrast, conventional closed-end mutual funds can only leverage 1-2, or borrow one dollar per two dollars of investor equity.

This increase in permitted leverage represents a massive and unjustified expansion in risk to BDC investors, which is particularly significant since BDCs market to ordinary retail investors. It is important to note that this fund-level leverage is in addition to the leverage that already exists in BDC portfolio holdings, due to investments in risky subordinated debt and structured products. For example, research from Wells Fargo shows that effective leverage at many large

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[8] Designated FMUs include the Clearing House Payments Company, L.L.C., on the basis of its role as operator of the Clearing House Interbank Payments System - (Fed); CLS Bank International - (Fed); Chicago Mercantile Exchange, Inc. - (CFTC); The Depository Trust Company - (SEC); Fixed Income Clearing Corporation - (SEC); ICE Clear Credit L.L.C. - (CFTC); National Securities Clearing Corporation - (SEC); and The Options Clearing Corporation - (SEC). *See* the Federal Reserve's "Designated Market Utilities" for more information, available at: https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm

[9] Anzhela Knyazeva, "Regulation A+: What Do We Know So Far?" U.S. Securities and Exchange Commission, November 2016. Accessed November 11, 2017. Available at https://www.sec.gov/files/Knyazeva_RegulationA%20.pdf.

BDCs is already 5-1 or greater.[10] This means that a doubling of permitted regulatory leverage could lead to effective leverage of up to 10-1, or ten dollars in debt for each dollar in equity. These high leverage ratios expose retail investors and retirees to a significantly greater risk of investment losses. As outlined by Professor Mercer Bullard in his recent testimony, BDCs already charge much greater fees to investors than comparable investment products.[11] It would add insult to injury to permit BDCs to also increase the risk of investment losses by significantly boosting their leverage.

Nor is there any evidence that this increase in permitted leverage is needed to serve the public policy goals of the BDC structure, which is channeling funds to small and mid-market operating companies. It would be much more effective for BDCs to attract additional capital by offering a better deal and lower fees to investors, rather than increasing the risk to investors and to the companies they support by increasing their borrowing. Furthermore, as Professor Bullard documented in his testimony, BDCs are currently investing a large fraction of their funds in other financial companies and securitization structures, rather than directly supporting operating small businesses. Passing this bill would only increase profits for BDC managers while harming investors, at no clear benefit to small businesses. We urge you to reject it.

HR 4279, "Expanding Investment Opportunities Act" – HR 4279 would allow closed end investment funds to take advantage of a wide range of exemptions from standard offering rules that have been created for operating companies. Closed-end funds are actively managed investment vehicles with a fixed number of traded shares that are generally considered riskier and more volatile than open-ended funds such as mutual funds. Opening operating company exemptions from offering rules to closed-end funds would significantly reduce investor protections for purchasers of closed-end funds, for example by greatly reducing and in some cases eliminating SEC staff review of the registration statements for fund offerings. Disclosures to investors and the transparency of these funds would be reduced if numerous ways by HR 4279, thus making it easier to use deceptive and misleading practices to sell these funds. Closed-end funds are purely financial vehicles, not operating companies, and it is thus inappropriate to open exemptions designed for operating companies to these funds. Furthermore, they are among the riskiest and most complex financial vehicles for retail investors, making it even more dangerous to permit them to make use of numerous exemptions from investor protections. HR 4279 should be rejected.

HR 4292, "The Living Will Improvement Act" – The living will or resolution planning process is one of the most important new protections against future big bank bailouts created by the Dodd-Frank Act. Regulators use the resolution planning process to try to ensure that large banks are not "too big to fail" – that they have adequate internal liquidity and are properly structured to permit them to go through a conventional bankruptcy without causing excessive economic disruption. HR 4292 would change the living will process by creating a statutory mandate prohibition that bans regulators from requiring resolution plans from bank holding

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[10] Bock, Jonathan, Finian O'Shea and Joseph Mazzoli, "Equity Research: The Q4 2015 BDC Scorecard", Wells Fargo Securities, September 10, 2015.

[11] Bullard, Mercer, "Testimony at Hearing Entitled Legislative Proposals to Improve Communities and Small Businesses Access to Capital", November 3, 2017. https://financialservices.house.gov/UploadedFiles/HHRG-115-BA16-WState-MBullard-20171103.pdf

companies or depositories more often than once every two years. The bill also requires regulators to return feedback on these plans within six months of receipt, and to publicly disclose the "assessment framework" they use in assessing the adequacy of resolution plans.

While these changes would not radically undermine the living will process like some other changes that have been suggested, we believe they are unnecessary, and send the wrong message to regulators about this process. Dodd-Frank already permits regulators complete discretion as to the frequency of resolution plan submission, requiring only that they be "periodic". While a two year cycle may be appropriate in most cases, placing such a limit in statute would tie regulators hands in some future circumstance when rapid shifts in the markets require quick updates to resolution plans. It is also unclear what a public disclosure of the "assessment framework" for living wills would mean beyond the significant disclosures that regulators have already made concerning their assessment process. The bill in its current form is both unnecessary and could create negative effects in some cases. Therefore, it should be rejected.

HR 4293, "The Stress Test Improvement Act" – Far from improving big bank stress tests, HR 4293 would have a disastrous impact on this central element of bank supervision. Former Federal Reserve governor Daniel Tarullo has called stress tests -- forward-looking checks of whether big banks have enough resources to absorb potential future losses -- the "key innovation in capital regulation and supervision" since the crisis. It is crucial to stress testing that this process be a true test, an external check on the adequacy of bank capital planning. But HR 4293 would require regulators to release in advance for public comment the exact models and assumptions used to test bank portfolios and predict losses. Like showing a test to students in advance, this would permit big banks to game the system by rigging their portfolios to match the models. Releasing these details under a notice and comment process would also permit big banks to sue in court to challenge any detail of the regulatory oversight model that was used, slowing the stress testing process to a crawl and subjecting regulatory experts to judicial veto.

This provision alone would be devastating to the effectiveness of the stress test process. But HR 4293 also undermines stress testing in numerous other ways. It bans regulators from doing stress tests any more frequently than once every two years, more than enough time for major shifts to take place in bank risks and capital positions. It bans regulators from failing banks based on "qualitative" objections to their stress test processes, meaning that regulators could not withhold assent to bank capital plans based on inadequate bank data management or risk measurement. Since regulatory stress test results are crucially dependent on risk data supplied by banks, these "qualitative" elements are in fact critical to the effectiveness of stress testing as a whole. Finally, HR 4293 also adds a host of broad and ill-defined new analytic requirements regulators must satisfy, such as measuring all the "institutional and systemic risks" their testing models might potentially contribute to, before they engage in the basic task of assessing whether bank capital is adequate to predicted bank losses.

HR 4293 would devastate stress testing oversight of big banks and should be rejected.

HR 4296 – "To Place Requirements on Operational Risk Capital Requirements For Banking Organizations" – This legislation is a transparent effort to boost big bank profits by reducing the capital held to protect the financial system and the public against the effects of a megabank failure. HR 4296 undermines regulatory authority to require operational risk capital at large banks. Operational risk capital is a new capital protection instituted at banks with over $250 billion in assets, to protect against the possibility that poor risk management or illegal behavior by bank employees will cause significant losses. Crucial areas of potential bank losses, including cyber risk, rogue traders, erroneous risk measurements, and legal judgements, all fall under the heading of operational risk.

Operational risk capital is a central part of the capital added to make big banks safer since the financial crisis. It accounts for hundreds of billions of dollars in capital at large banks -- a fifth to a third of the total risk-based capital held against potential future losses at the largest banks in the country is operational risk capital.[12]

HR 4296 would weaken operational risk capital by creating a statutory mandate that such capital requirements must be based "primarily" on the banks current activities, cannot be based "solely" on historical losses, and must permit adjustment based on "operational risk mitigants". While current activities are obviously central to operational risk, and are already treated as such, the recent loss experience of banks is the best concrete evidence regulators usually have as to the magnitude of current and future risks. Recent past activities are also vital to understanding the future exposures of the bank, including potential legal exposures. Creating a statutory requirement that restricts the use of this evidence is a blow against evidence-based policymaking. It would open regulators up to lawsuits if they used clear evidence from the recent past activities and losses of a bank in setting capital requirements. HR 4296 is a transparent attempt to pressure regulators to reduce capital protections at the nation's largest banks, and must be rejected.

If you have questions, please contact AFR's Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672. Thank you for your attention to this letter.

Sincerely,

Americans for Financial Reform

[12] https://www.wsj.com/articles/the-93-words-that-could-unlock-more-than-200-billion-in-trapped-bank-capital-1493553602