December 12, 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 markup.[1]

Today's markup continues the rush to loosen controls on Wall Street that has been particularly evident in the Financial Services Committee the last several months. Over the past two months, the Committee has marked up sixty bills, most of which have been deregulatory, and none of which have enhanced consumer protections or oversight of the financial sector.

As we have stated previously, 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

One notable characteristic of today's markup is that it contains many bills that would significantly undermine systemic risk protections designed to prevent a repeat of the large-scale taxpayer bailouts that occurred during the 2008 financial crisis. For example, HR 2319 would reverse post-crisis reforms to money market funds, which received a massive public bailout during the 2008 crisis. HR 3179 would endanger the public by making it more difficult for regulators to require additional private capital and other protections at the nation's largest banks, giving big banks new ways to sue in court to reverse regulatory requirements that exceeded minimum levels set by international regulators. HR 4545 would severely limit the long-standing authority of bank supervisors to address risky and harmful practices by setting up an elaborate new appeals process that would significantly delay or possibly reverse the effect of any supervisory decisions.

Below, we have laid out specific objections to eight of the bills being marked up by the Committee today.[2] While these bills vary in the degree and kind of risk they pose to the financial system, all raise significant concerns that should lead Congress to at least re-examine them.

CONCERNS ABOUT SPECIFIC BILLS

We address the bills in numerical order below.

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[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] Several of the bills not discussed in this letter fall outside the scope of AFR's coverage of financial regulatory issues.

HR 2319: The "Consumer Choice and Capital Markets Protection Act": This legislation would reverse key 2014 reforms to rules governing Money Market Funds (MMFs). During 2008 crisis, declines in the value of money market funds that were overinvested in risky bank debt eventually led to a multi-hundred billion dollar run on the entire sector of prime money market funds. Due to the threat to financial stability and the broader economy, the Federal government intervened to provide a public guarantee to the entire money market fund sector. This succeeded in stopping the run, but exposed the government to the potential loss of hundreds of billions of dollars.[3]

In response to these events, regulators took several steps to require that a key subsector of money market funds -- institutional prime funds -- report accurate information to their investors about the current market value of their holdings. In a technical sense, this is a requirement that funds report a so-called "floating Net Asset Value" (NAV) which represents the true market value of their holdings, rather than a fixed NAV which gives the impression that each share in a money market fund is worth one dollar. This reform became effective in October, 2016.[4]

This regulatory change enhances financial stability by helping to ensure that fund investors are prepared for fluctuations in the value of their funds and are less likely to engage in a disorderly exit from the sector when prices start to shift. It also makes clear that shares in money market funds are market investments that carry risk. The floating NAV is designed to lessen the impression that shares in money market funds are similar to insured bank deposits, thus lessening the perception that they are implicitly backed by the government.

HR 2319 would reverse the regulatory response to the crisis by once again permitting institutional prime funds to report an inaccurate fixed value for their holdings, thus encouraging investors to view these instruments as the equivalent of bank deposits, which they are not. Funds affected by this regulatory change are funds invested in by large institutional investors, not retail investors, and only "prime" funds that hold securities not guaranteed by the Federal government are affected.

HR 2319 purports to address the increased threat of a taxpayer bailout created by this change by prohibiting Federal government bailouts of money market funds. However, the definition of "covered Federal assistance" that is prohibited in the bill deliberately omits the actual types of Federal Reserve assistance that money market funds would receive. Specifically, the legislation

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[3] McNamara, Christian, "Temporary Guarantee Program for Money Market Funds", Yale Program on Financial Stability Intervention Case Study, January 13, 2016. Available at SSRN: https://ssrn.com/abstract=2723529 or http://dx.doi.org/10.2139/ssrn.2723529
[4] "Money Market Fund Reform; Amendments to Form PF", Investment Company Act Release No.31166, July 23, 2014.

exempts a “facility with broad-based eligibility established in unusual or exigent circumstances” from the definition of “covered Federal assistance”. This language would exempt Federal government assistance provided under Section 13(3) of the Federal Reserve Act from any prohibition on bailouts under this bill. This leaves the door open to future Federal Reserve assistance being provided to money market funds.

Congress should not reverse key regulatory changes made in response to the government bailout of money market funds during the crisis, and should maintain the requirement to report more accurate fund valuations to investors. In recent testimony to the Committee (October 4, 2017), SEC chair Jay Clayton has expressed his view that any such change would be premature at best. We urge the Committee to reject HR 2319.

HR 3179 would impose additional barriers to action on Federal banking agencies in cases when they wished to issue bank safety and soundness regulations that were more stringent than those laid out by international regulatory bodies.

Passing this bill would subordinate the safety of the broader American economy to the desire of a small number of America’s largest banks to increase their return on equity by avoiding regulatory oversight. If rules made by international regulatory bodies such as the Basel Committee on Banking Supervision (BCBS) were conceived as dictating the strongest level of safety and soundness that could be required by U.S. regulators, this would result in imposing the lowest common denominator of regulatory protection acceptable to the more than two dozen nations that are members of the Basel Committee on U.S. regulators Such a restriction would be very dangerous.

This risk is particularly salient today, given the weaknesses in the European banking system. The prominent role of European countries in the Basel process means that it is difficult to reach international agreements setting standards that European banks find it difficult to meet. The European banking system is far weaker than the U.S. system, with banks less profitable, less well capitalized, and the system at greater risk of a potential banking crisis.[5] This in practice means that Basel rules can be deeply influenced by the desire of European regulators to avoid placing stress on very weak and in some cases perhaps even insolvent banks. Subordinating U.S. bank regulations to what is attainable in a Basel consensus would be an extremely dangerous move.

HR 3179 does not explicitly forbid U.S. regulators from exceeding Basel minimum standards. However, the requirement for special additional analysis to justify such action is clearly designed to discourage them from doing so. Furthermore, the listed considerations for the analysis are exclusively focused on the costs to regulated entities and the financial system, and do not include any of the costs to the economy that could be created by inadequate prudential rules. Such an

[5] The Economist, “American Banks Have Recovered Well, Many European Banks Much Less So”, Economist Special Report, May 6, 2017; http://econ.st/2sek3hJ

analysis would be weighted from the beginning against taking stronger action than the Basel minimum.

Even regulations that are very well justified analytically could be overturned or undermined by the kind of requirements in HR 3179. The statutory analytic requirements in HR 3179 could and would be used as the basis for lawsuits by large Wall Street banks seeking to weaken safety and soundness regulations to increase their own profits at the risk of our country's financial security. Modeling the effects of regulation on the economy is heavily dependent on assumptions, and it is easy to pay consultants to develop a model that will minimize benefits and exaggerate costs. Courts judging lawsuits based on cost-benefit analysis may not be expert in the quantitative analysis of financial regulation, but their decisions in lawsuits enabled by bills like HR 3179 could strip away important financial protections advocated by expert regulators.

The effect of this bill would be to aid a small number of the largest banks in the country, since the great majority of the cases where regulators have exceeded Basel minimum requirements are limited to regulation of the largest and most systemically significant banks. But its cost would fall on the general public through increased risk of financial instability. Over the long run, it would also not act to boost lending, and would be far more likely to harm the flow of sound lending to the economy. Adequate capitalization promoted by strong financial regulation supports the flow of lending over the economic cycle, and prevents situations where banks under stress sharply cut back their lending.[6] We urge the Committee to reject HR 3719.

HR 4464 would eliminate the National Credit Union Administration's (NCUA) "Risk-Based Capital" rule requiring credit unions taking certain risks to hold capital in proportion to those risks. It is appropriate for Congress and regulators to seek to limit negative impacts of unnecessary or unjustifiably burdensome regulations on small credit unions. However, at the same time Congress should be aware that credit unions hold $1.3 trillion in assets, almost all of which are Federally insured and thus involve public exposure. Currently the Credit Union Share Insurance Fund holds only $13.2 billion to cover losses on insured credit union deposits, a ratio of just one cent on each dollar of assets.[7] Any significant losses on insured deposits due to credit union insolvency would trigger the need for solvent credit unions to pay significant amounts into the insurance fund, and/or create public exposure that could require greater government resources from taxpayers.

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[6] See Hoenig, Thomas, "Letter to Chairman Crapo and Ranking Member Brown", July 31, 2017. Available at https://www.fdic.gov/about/learn/board/hoenig/hoenigletter07-31-2017.pdf

[7] National Credit Union Administration, "Industry At A Glance, June 2017. https://www.ncua.gov/analysis/Pages/industry/industry-at-a-glance-june-2017.pdf

This is not just a theoretical danger. During the financial crisis dozens of credit unions failed, and the Federal government was forced to place large "wholesale" credit unions into public conservatorship due to large unexpected losses on subprime mortgage securities.[8]

According to the NCUA the final risk based capital rules exempts all small credit unions with under $100 million in assets, accounting for 76 percent of credit unions nationally, and among the 1,489 credit unions with over $100 million in assets subject to the rule, just 16 credit unions would be downgraded in their capitalization classification due to the new risk based asset requirements.[9] We recommend that Congress work with the NCUA to investigate means of assisting credit unions that are less extreme than simply repealing new risk based capital rules.

HR 4529 would greatly expand exemptions from listing and registering individual public offerings under the SEC Form S-3. The bill would permit any exchange-listed company to use so-called "shelf registration," which allows multiple offerings under the same registration and financial disclosure.

The "shelf registration" system was designed to enable well known, seasoned companies to access the markets more quickly, without undergoing prior review of their offering documents by the staff of the Securities and Exchange Commission (SEC). In 2007, SEC extended the privilege of shelf registration to the smallest public companies, those with a public float of less than $75 million, if they met three conditions associated with reduced risk of fraud: 1) the company's shares are traded on a national exchange, 2) the company is not a shell company, and 3) it has not issued common equity in reliance on the exception in excess of one-third of the value of its public float in the preceding year.

HR 4529 would permit any exchange-listed company, regardless of size, to issue an unlimited number of shares in a given year using shelf registration. Worse, it would allow non-exchange-listed companies (e.g., those sold in the "pink sheets") to sell up to one-third of the aggregate market value of their common equity using shelf registration. Even more troubling, this legislation would also allow companies not even listed on a national securities exchange to publicly offer up to one-third of the aggregate market value of their common equity using shelf registration and with little to no vetting from the SEC. This would facilitate accounting fraud, market manipulation, and insider trading, all of which have been found to be more common among micro-cap companies and particularly among non-exchange-listed companies. For example, a 2006 study of SEC enforcement actions found that 80 percent of manipulation cases involved non-exchange-traded stocks.[10] A more recent study has found that over-the-counter

[8] Maremont. Mark and Victoria McGrane, "Credit Unions Bailed Out", *Wall Street Journal,* September 25, 2010. http://on.wsj.com/2j2Jin9
[9] National Credit Union Administration, "Frequently Asked Questions: Risk Based Capital Rule", https://www.ncua.gov/Legal/Documents/RBC/RBC-Final-Rule-FAQs.pdf
[10] Rajesh Aggarwal and Guojon Wu, Stock Market Manipulations, 79 Journal of Business 1915, 1935 (2006). This total includes 29.58 percent of cases involving stocks for which market information was unavailable (which therefore presumably were not traded on a national securities exchange).

(OTC) stocks are less liquid and more volatile than exchange-traded stocks, making them more prone to manipulation.[11] It was in light of these concerns that the Commission adopted its current requirements, requirements that would be stripped away by this bill.

The shelf registration process allows well-known, reliable companies to quickly access securities markets without previous review of the offering documents by the SEC. However, the great expansion in the use of shelf registration allowed by HR 4529 would reduce the transparency and basic regulatory oversight needed to maintain the integrity of capital markets. This bill not only poses a risk to the capital formation process, it would also make investors and small businesses far more vulnerable to market manipulation and accounting fraud. It should be rejected.

HR 4537 would forbid the United States from entering into any international insurance standard or agreement unless it was consistent with existing law in all fifty states, and would also subject U.S. positions in such international insurance agreements to a Congressional veto process.

The large international insurance conglomerates that dominate the U.S. and global insurance market today are active far beyond the boundaries of any individual state. While state-based insurance regulation may be appropriate for key areas of insurance company oversight such as policyholder and consumer protection, the implications of insurance company activity for the safety and soundness of the broader financial system go beyond the purview of any single state regulator. One of the lessons of the 2008 financial crisis was the failure of state-based regulation to address problems at AIG Insurance, which received the largest Federal bailout every given to a single company. As Professor Dan Schwarcz said during Congressional testimony on the subject, “the benefits of reducing systemic risk are felt almost entirely outside of the boundaries of any individual state. For this reason, systemic risk regulation should generally be conducted at the national and international levels.”[12]

Currently, state regulators are given a substantial consultative role in international insurance regulations. However, HR 4537 would expand this role to an inappropriate degree by effectively giving any of the fifty states veto power over U.S. commitments in international insurance agreements designed to address consolidated prudential supervision of global insurance companies. This would be impractical and unworkable, and would make it extremely difficult if not impossible for the U.S. to participate in such agreements. Congress should reconsider the practicality of sweeping legislation like HR 4537 and, if it acts at all, take more modest and limited measures to enhance the state role in international insurance negotiations.

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[11] Ulf Brüggemann, Aditya Kaul, Christian Leuz, and Ingrid M. Werner, The Twilight Zone: OTC Regulatory Regimes and Market Quality, Fisher College of Business Working Paper No. 2013-03-09 (August 1, 2013) available at ssrn.com/abstract=2290492.

[12] Testimony of Professor Daniel Schwarcz, Housing and Insurance Subcommittee hearing entitled, “The Federal Government’s Role in the Insurance Industry”, October 24, 2017.

HR 4545 creates a protracted process of appeals and reviews of bank regulatory agencies' supervisory determinations. This process would create numerous opportunities for banks to delay and derail changes that supervisors had found necessary to protect consumers, the public, and banks' own safety and soundness.

HR 4545 would grant regulated banks the right to appeal any supervisory determination made by any prudential banking agency or by the Consumer Financial Protection Bureau (CFPB) to a new "Office of Independent Examination Review" established in the Federal Financial Institutions Examinations Council (FFIEC). Upon appeal by a supervised bank, this new office would be required to undertake a de novo review of the agency's supervisory decision. No deference to the initial examination findings or the agency's judgment would be required in this review.

This new appeals process is an addition to formal appeals processes and ombudsmen already present at the banking agencies. The agencies affected by this legislation—including the CFPB, FDIC, OCC, Federal Reserve, and National Credit Union Administration—each already have an agency ombudsman and an intra-agency formal review and appeals process. In addition, banks may bring a court challenge to any formal regulatory enforcement action.

By layering an entirely new de novo appeals process on top of existing processes, this legislation would multiply red tape and delays in supervisory decisions. Since there is no bank size limits in the bill, this effect would be most pronounced at the largest banks, who could appeal dozens or hundreds of material findings from every examination, creating major roadblocks to supervisory effectiveness.

The bank supervision process has been the first line of regulatory defense against threats to bank safety and soundness for a century or more. HR 4545 creates unprecedented roadblocks to the effectiveness of bank supervisory determinations and dangerously undermines the scope of effective regulatory oversight in areas ranging from basic prudential oversight to to key consumer protections that make our financial markets fairer. We urge the Committee to reject this legislation.

HR 4546 would dangerously expand Federal pre-emption from state securities laws designed to protect investors from securities fraud. Under current law, a national securities exchange needs to meet listing standards similar to those of a major national exchange—e.g., the New York Stock Exchange, NASDAQ—for its securities to be deemed "covered securities." Under this classification, securities enjoy the advantages of exemptions from state-level regulations.

HR 4546 would amend the Securities Act of 1933 to remove the requirement that companies meet listing standards rigorous enough to be considered similar to those of major exchanges, effectively allowing riskier, less liquid securities to qualify as "covered securities" and avoid state securities laws designed to protect investors and financial markets. Under HR 4546, a security would be preempted as long as it is traded on a national exchange that is a member of the National Market System. This would mean that securities could be exempted from oversight by state securities regulators without meeting the strong standards that the SEC has laid out for individual securities to qualify for pre-emption under Section 18 of the Securities Act.

Both the North American Securities Administrators Association (NASAA), the main body of state securities regulators, and the chief securities regulator for the Commonwealth of Massachusetts have made the dangers of this bill clear in strongly worded opposition letters.[13] In these letters, they advocated for fair and rigorous listing standards as essential to protect retail investors and savers, to maintain high standards for corporate governance, and to avoid conflicts of interests that harm investors. HR 4546 unacceptably weakens these listing standards and the Committee should reject it.

HR 4566 would exempt large nonbank financial institutions from annual stress tests requirements included in the Dodd-Frank Act This legislation would remove the Board of Governors' discretion to require annual stress tests from non-SIFI-designated nonbank financial companies. The bill would also eliminate the current requirement that the lead Federal regulator of a non-bank entity conduct an annual stress test for all nonbank financial companies with more than $10 billion in total consolidated assets and regulated at the Federal level.

The failure of nonbank financial institutions like Bear Sterns, Lehman Brothers, and AIG Insurance was among the events that precipitated the last global financial collapse.[14] Had such institutions regularly evaluated their capacity to absorb and manage losses in an adverse economic environment, grave damage to our economy might have been avoided.

Today, large asset managers such as Blackrock manage trillions of dollars and their risk management procedures are essential to the health of the financial markets. Such entities should be subject to stress testing, and the Committee should reject HR 4566.

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

[13] North American Securities Administrators Association (NASAA), "Letter from NASAA President and Alabama Securities Director Joseph P. Borg to the Senate Committee on Banking, Housing and Urban Affairs Chair regarding Section 212 of S. 2155 (National Securities Exchange Parity," December 5, 2017. Available at http://bit.ly/2C1y5Il; The Commonwealth of Massachusetts, "Letter from the Secretary of the Commonwealth William F. Galvin to Senator Elizabeth Warren regarding Opposition to Section 212 of S. 2155, the 'Economic Growth, Regulatory Relief, and Consumer Protection Act.'" December 4, 2017.

[14] Larry D. Wall, "Nonbank Financial Firms and Financial Stability," Federal Reserve Bank of Atlanta. November 2014. Available at http://bit.ly/2knsyDI.