February 13, 2018

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to urge you to vote in opposition to H.R. 3978, which is being considered on the House floor today.[1] This legislation is a grab bag of bad legislative ideas that should never have advanced through the House Financial Services Committee. Especially notable given the recent wild swings in stock prices, Title II of this bill would sharply limit the ability of the Securities and Exchange Commission (SEC) to investigate high-frequency automated trading strategies that can disrupt markets. But that is hardly the only harmful bill in this package. There are several other provisions that would weaken consumer and investor protections.

Title I, "TRID Improvement," would amend the TILA/RESPA Integrated Disclosure Rule (also known as TRID) to change how title insurance fees are disclosed, in a manner that would increase confusion and potentially misinform consumers as to the final cost of these important fees. The title insurance market already lacks transparency and fairness; fees are grossly inflated in relation to the value of the insurance. The Consumer Financial Protection Bureau (CFPB) carefully studied this issue in its rulemaking to determine the clearest and most accurate way to disclose fees in light of varying state laws on title insurance and differences in practices by different companies.[2] The changes in the statutory language here would limit the CFPB's authority to create a consistent method of disclosure across different companies and different states, and to reflect ways in which title insurance costs can change at closing. Further refinement in title insurance disclosures can be addressed through rulemaking by the CFPB itself in consultation with stakeholders.

Title II, "Protection of Source Code," would severely restrict the ability of the SEC 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. Title II would prevent regulators from inspecting not only the raw source code used in automated trading, but also any related intellectual property that "forms the basis for the design of" source code. Examination of such intellectual property would only be possible in an enforcement context pursuant to a subpoena. This implies that the SEC would have to wait until the damage was done through a

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

[2] See CFPB, *Final Rule: Amendments to Federal Mortgage Disclosure Requirements under the Truth in Lending Act (Regulation Z)*. Available at http://bit.ly/2t6xtvb.

"flash crash" or similar market disruption before taking any action, which would have to be retrospective.

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) are part of the books and records routinely 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 clearly involves trading strategies, which have always been a subject for regulatory inspection and oversight.

The continued high volatility on Wall Street is giving evidence of the potential systemic dangers of high-frequency automated trading.[3] Now is not the time to tie the SEC's hands in doing oversight of such trading.

Title III, "Fostering Innovation," 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 piece of the legislation would both harm investors and undermine the integrity of our capital markets.

Title IV, "National Securities Exchange Regulatory Parity," 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.

Title IV in H.R. 3978 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 this section of H.R. 3978, a security would be exempt from state-level fraud protections 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 pre-empted from the oversight of state securities regulators without

[3] Harwell, Drew, "A Down Day on the Markets? Analysts Say Blame the Machines," *Washington Post,* February 6, 2018. Available at http://wapo.st/2BTxBXL.

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 legislation clear in strongly worded opposition letters.[4] 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. Title IV of H.R. 3978 unacceptably weakens these listing standards.

The sections of H.R. 3978 discussed above are, individually, bad bills for consumers and investors rights and protections. Packaging them together only worsens the harm. We urge you to reject H.R. 3978.

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

Sincerely,

Americans for Financial Reform

[4] 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.