PUBLIC CITIZEN Protecting Health, Safety and Democracy

October 10, 2017

Honorable Member
House Committee on Financial Services
2128 Rayburn Building
Washington, D.C. 20515

Dear Honorable Member

On behalf of more than 400,000 members and supporters of Public Citizen, we offer the following comments on 23 bills slated for a vote before the House Financial Services Committee beginning Oct. 11, 2017. These measures put Americans at risk to a rapacious financial sector. Some bills threaten vulnerable citizens, including purchasers of manufactured housing. Others gut protections for retirement savers, such as through the elimination of a new rule requiring Wall Street to serve the investor's best interests. Still others undermine the systemic safety of the sector through reduced capital standards.

These bills ignore basic economic realities and consumer interests. First, the financial crash of 2008 cost millions of Americans their jobs, their homes and their savings. Congress approved reform to reduce the chance of another such tragedy. Second, the economy and even the banking sector have rebounded. Unemployment is down, the economy is growing. Banks are recording robust profits. And finally, Americans want a well-regulated Wall Street. A recent poll commissioned by the libertarian Cato Institute finds that a majority say regulations help, and 64 percent think Wall Street bankers "get paid huge amounts of money" for "essentially tricking people."[1]

Yet these bills largely make "tricking people" that much easier.

We address the bills in ascending numerical order, though this not an exhaustive analysis of the problems with all of the separate pieces of legislation.

H.R. 477, Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017

This bill would increase to $250 million the revenue size of companies that can be merged with the service of an agent who is not a registered broker-dealer. While unregistered agents might be appropriate for the sale of a truly small firm, such as the local dry cleaner or restaurant, a firm with $250 million in revenue doesn't count as small. We oppose this bill.

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[1] Emily Ekins, *Results from Cato Institute 2017 Financial Regulation Survey,* CATO INSTITUTE (September 19, 2017) https://www.cato.org/survey-reports/wall-street-vs-regulators-public-attitudes-banks-financial-regulation-consumer

H.R. 1116, TAILOR Act of 2017

This bill directs the federal financial regulatory agencies to reduce the scope of rules based on the size and profile of the institution. Already, the agencies have adjusted rules. The Consumer Financial Protection Bureau (CFPB) has exempted small community banks from numerous requirements associated with new "qualified mortgage" rules. The Federal Reserve has established different capital requirements based on size. These adjustments were the result of the comment process used for all rules. The TAILOR Act, however, complicates this process by adding requirements inconsistent with sound public policy. For example, any rule must be "tailored" to "limit liability risk." This means that rules should be written such that, if broken, there is limited liability for those responsible. This would render a rule meaningless, since there would be little repercussion for breaking it. We oppose this bill.

H.R. 1585, Fair Investment Opportunities for Professional Experts Act

This bill would expand the population of customers who would qualify as an "accredited investor," a designation that permits a person to invest in unregistered securities offerings. It is assumed that such investors are more sophisticated or have incomes and assets such that they can suffer losses without significant harm to their overall financial well-being.

The SEC Investor Advisory Committee (IAC) addressed this issue and offered recommendations for adjusting this definition.[2] The bill includes some of these recommendations. One that deserves consideration by the committee includes limiting any investment in an unregistered offering to a percentage of assets or income, similar to the rules that apply to crowdfunding. An investor who loses 100% of her savings, whether that be $1 million or $10,000 has still lost 100%.
We support this amendment; without it, we oppose this bill.

H.R. 1645, Fostering Innovation Act of 2017

This bill amends Section 404(b) by increasing from five to ten years the time that CEOs of firms with less than $50 million in revenue must attest to the accuracy of their financial reporting. The Sarbanes-Oxley Act (SOX) was approved in response to the accounting scandals at the turn of the millennium. They are designed to promote accounting accuracy to the shareholders who have entrusted their savings to these firms. A Government Accountability Office (GAO) report found that companies that do not have an audit of their internal controls over reporting have a significantly higher likelihood of issuing a restatement of their financial statements.[3]

Firms who are unwilling to oblige SOX should not be trusted with the capital of savers. Extending from five to 10 years exacerbates the problem. From an investor perspective, accounting safeguards are more important for smaller companies, since larger companies generally attract a larger and more sophisticated base of stock and bond holders who can perform effective oversight. We oppose this bill.

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[2] SEC Investor Advisory Committee, *Recommendation of the Investor Advisory Committee: Accredited Investor Definition*, SECURITIES AND EXCHANGE COMMISSION (Oct. 9, 2014), https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-advisor-accredited-definition.pdf

[3], *Internal Controls: SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (July 2013), http://www.gao.gov/assets/660/655710.pdf.

H.R. 1699, Preserving Access to Manufactured Housing Act of 2017

This bill would exempt manufactured housing sales people from marketing and documentation rules established and enforced by the CFPB. It would also increase allowable fees. Specifically, it would increase the spread over the average prime offer rate (APOR): from 6.5 percent to 10 percent for loans between $50,000 and $75,000 and from 8.5 percent to 10 percent for loans under $50,000.

This removes safeguards from manufactured housing purchasers that apply to buyers of conventional homes. Given that many purchasers of manufactured housing may have lower incomes, protections should be greater, not less. When this bill was last addressed in the committee, the Obama administration issued a Statement of Administration Policy, noting that it puts consumers "at significant risk of being subjected to predatory lending and being steered into more expensive loans."[4] We oppose this bill.

H.R. 2121, Pension, Endowment, and Mutual Fund Access to Banking Act

This bill would exempt central bank placements from the calculations to determine the applicable supplementary leverage ratio. These are funds of a custodial bank that are deposited with the Federal Reserve.

The Federal Reserve has elected to use capital, namely, the difference between assets and liabilities, as the principle safeguard against mega-bank insolvency and the jeopardy of taxpayer bailouts. While we support the steps that the Fed has taken so far, we believe they have fallen short. The basic leverage ratio, according to Federal Deposit Insurance Corp (FDIC) Vice Chair Thomas Hoenig, who publishes an annual analysis, is between 6.8 percent, using International Financial Reporting Standards, and 8.3 percent, using Generally Accepted Accounting Principles, for the largest banks.[5] Public Citizen believes the figure should be 20 percent, as the largest banks reported losses to assets above 18 percent in the 2008 financial crash. This bill takes the leverage ratio in the opposite direction. We oppose this bill.

H.R. 2148, Clarifying Commercial Real Estate Loans

This bill would reduce the capital requirements for High Volatility Commercial Real Estate (HVCRE). During the recent financial crisis, this sector caused major losses, especially at smaller banks. The GAO found that failures of small banks "were largely driven by credit losses on commercial real estate (CRE) loans, particularly loans secured by real estate to finance land development and construction."[6] We oppose this bill.

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[4] Statement of Administration Policy on H.R. 650, (April 13, 2015)
ttp://www.presidency.ucsb.edu/ws/index.php?pid=110001

[5] Thomas Hoenig, *Global Capital Index,* FDIC (website visited October 9, 2017)
https://www.fdic.gov/about/learn/board/hoenig/capitalizationratio2q2017.pdf

[6] *Causes and Consequences of Recent Community Bank Failures*, GENERAL ACCOUNTING OFFICE (June 13, 2013) https://www.banking.senate.gov/public/_cache/files/703ee6fe-c8cb-4c7f-a5f1-773f2ab117b8/33A699FF535D59925B69836A6E068FD0.evanstestimony61313.pdf.

Also see this comprehensive report from the FDIC's Inspector General, https://www.fdicig.gov/reports13/13-002ev.pdf, and the TARP's Congressional Oversight Panel's report, Commercial Real Estate Losses and the Risk to Financial Stability, https://www.gpo.gov/fdsys/pkg/CPRT-111JPRT54785/pdf/CPRT-111JPRT54785.pdf.

H.R. 2201, Micro Offering Safe Harbor Act

This bill removes basic protections from offering securities provided that the purchasers have a pre-existing relationship with an officer, director, or shareholder with 10 percent or more of the shares of the issuer, and the aggregate amount of all securities sold by the issuer does not exceed $500,000 during a 12-month period. This would permit small offerings with no investor protections, such as a notice of the offering. It will enable a type of affinity fraud, where the seller can unload dubious securities provided there is some relationship between seller and purchaser. The bill assumes that a pre-existing relationship will deter abuse, which is a tenuous foundation, at best. Further, the relationship can begin with the offer. The bill says the relationship must only exist before the purchase. We oppose this bill.

H.R. 2396, Privacy Notification Technical Clarification Act

This bill would eliminate the annual notice to consumers that they are able to opt-out from having their personal information shared and sold to unaffiliated third-party companies. Given the data breach at Equifax and many other institutions, this is an unwise time to prevent customers from taking available steps to protect their personal information. We oppose this bill.

H.R. 2706, Financial Institution Customer Protection Act of 2017

This bill amends the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 that restricts the Department of Justice's (DOJ) subpoena authority. FIRREA authorizes the DOJ to issue broad subpoenas without going to court. This allows the DOJ to engage in extensive pre-trial investigations. The DOJ has used these subpoenas to uncover mortgage fraud, and has resulted in substantial financial settlements against financial services companies. This bill would substantially undermine the DOJ's ability to prosecute mortgage fraud. We understand that a Republican amendment will seek to strike this provision in the bill. We support this amendment; without it, we oppose this bill.

H.R. 2954, Home Mortgage Disclosure Adjustment Act

This bill would eliminate race and gender home mortgage reporting requirements for lenders who make fewer than 500 closed-end mortgage loans, and fewer than 500 open-end lines of credit. There is really no benefit to such an exemption, as the reporting requirements are negligible. Lenders who write mortgages obtain significant data on their customers, as they should. Reporting a few items of this data is not cumbersome. The potential harm, on the other hand, is to subvert the basic intent of the Home Mortgage Disclosure Act, which is to publicize whether a bank is truly serving its geographic market on a race- and gender-blind basis. We oppose this bill.

H.R. 3072, Bureau of Consumer Financial Protection Examination and Reporting Threshold Act of 2017

This bill would set a threshold of $50 billion in assets for examination by the Consumer Financial Protection Bureau. That would eliminate 66 of the 100 institutions now examined by CFPB. Already, more than 6,000 banks are below the $10 billion threshold. This bill would expose more consumers to abuse by banks that do not fall under the CFPB's purview. While the financial crash grew largely from behavior by the mega-banks, consumer abuse isn't restricted to this class of bank. We oppose this bill.

H.R. 3299, Protecting Consumers Access to Credit Act of 2017

This bill would enable payday lenders and other predatory firms to use bank partnerships and escape state interest rate limits. The bill overturns the decision in *Madden v. Midland.*[7] There, the court ruled that a national bank couldn't end-run a particular state's interest rate caps.

While we believe that all states should limit interest rates, at least some states have. This bill effectively nullifies those states that have chosen to protect their citizens from predatory lenders. Members of Congress from those states without strong protections are attempting with this bill to export those bad practices across their borders. We oppose this bill.

H.R. 3312, Systemic Risk Designation Improvement Act of 2017

This bill would eliminate from special supervision by the Federal Reserve banks with more than $50 billion in assets. Currently, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes special oversight for these large banks. Many in this class contributed conspicuously to the financial crash of 2008, such as Countrywide, IndyMac and Washington Mutual. Under this bill, the Federal Reserve would need to make an affirmative decision to oversee these banks. In addition, it would need to clear a number of regulatory hurdles. This process would become politicized, just as the designation of a systemically important financial institution (SIFI) has become the subject of protracted contests within agencies, Congress and even during political campaigns. We oppose this bill.

H.R. 3758, Senior Safe Act of 2017

This bill would provide a safe harbor for trained bank officials who report suspicious activity related to possible financial abuse of elders to state and federal regulators, law enforcement agencies and adult protective services agencies. We support this measure.

H.R. 3857, PASS Act of 2017

This bill repeals the Department of Labor (DOL) conflict of interest (or "fiduciary") rule. This commonsense rule requires Wall Street agents to put the interest of their customers ahead of their own interests in maximizing sales fee revenues when making investment recommendations. Further, the bill reopens loopholes that make it easy for sales-based "advisers" to avoid their current fiduciary obligations under the Employee Retirement Income Security Act. The bill establishes a disclosure-only based system, which has been proven to be ineffective in protecting consumers from abuse.

The bill further prevents the SEC and DOL from adopting any requirements for brokers' recommendations that are "in addition to" the bill's requirements. State authority would also be broadly preempted. Thus, if these agencies wanted to adopt clarifying rules, shore up ineffective protections, or

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[7] *Madden v Midland Funding LLC*, UNITED STATES COURT OF APPEALS, SECOND CIRCUIT, (May 22, 2015) https://scholar.google.com/scholar_case?case=17183050865645712587&hl=en&as_sdt=6&as_vis=1&oi=scholarr

address unforeseen problems that may emerge in the future, they would be unable to do so. We oppose this bill.

H.R. 3911, Risk-Based Credit Examinations Act of 2017

This bill would allow the SEC's Office of Credit Ratings ("OCR") to reduce its oversight of nationally recognized statistical rating organizations (NRSROs), also known as credit rating agencies. In response to the inflated credit ratings for otherwise toxic securitizations, Congress mandated creation of the OCR and directed it to conduct annual examinations of each NRSRO and make its reports public. It must examine eight areas: (i) whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest by the NRSRO; (iii) the implementation of ethics policies by the NRSRO; (iv) the internal supervisory controls of the NRSRO; (v) the governance of the NRSRO; (vi) the activities of the Designated Compliance Officer (DCO) of the NRSRO; (vii) the processing of complaints by the NRSRO; and (viii) the policies of the NRSRO governing the post-employment activities of its former personnel. This bill would allow the SEC to reduce these categories of inspection to save staff resources. The answer is not to reduce inspections, but to increase the funding for the SEC. We oppose this bill.

H.R. 3948, Protection of Source Code Act

This bill would prohibit the SEC from securing the source code of algorithmic trading programs without a subpoena issued by the Commission.

This measure follows a 2015 action by the Commodity Futures Trading Commission ("CFTC") to broaden oversight of algorithmic trading in the wake of the trillion-dollar "Flash Crash" of May 6, 2010. One element of that crash proved to be an errant sell order from a flawed execution algorithm of one institutional investor, followed by aggressive algorithmic trading by high-frequency trading firms (HFTs) that rapidly eliminated their positions and withdrew from the markets in the face of uncertainty. The CFTC proposed a ''source code repository'' that could be inspected by CFTC staff. It then retreated and proposed that this access would follow a subpoena or a special call approved by the Commission itself, not by staff.

These special steps undermine agency powers. Federal law already authorizes SEC staff to examine broker-dealer records without a subpoena. Trading data directed by a machine should fall in the same category as that directed by a person. We oppose this bill.

H.R. 3971, Community Institution Mortgage Relief Act

This bill would amend the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) to widen the size of two exemptions that the CFPB has already provided for smaller sized institutions on escrow accounts for higher-priced mortgage loans and servicing requirements for small mortgage servicers. Under the bill, escrow accounts would no longer be required for riskier, high-priced loans at institutions with less than $50 billion in assets. Currently, the exemption applies to firms with less than $2 billion in assets. The small servicer exemption for increased notification requirements to consumers would be increased from servicers with 5,000 loans to those with 30,000 loans. We oppose this bill.

H.R. 3973, Market Data Protection Act of 2017

This bill would delay the implementation of the Consolidated Audit Trail (CAT) until the SEC has improved its data security. A breach in security at the SEC has called into question the integrity of the SEC's anti-hacker protections. CAT is a market surveillance system that tracks and records securities activity, including quotes, orders, executions, allocations, and associated broker-dealer and customer data. The purpose of CAT is to improve the ability of the SEC and the Financial Industry Regulatory Authority (FINRA) to surveil markets, determine the causes of unusual market gyrations, and investigate illegal conduct such as insider trading and market manipulation.

Ideally, security would protect data. Currently, additional efforts are certainly warranted. However, this bill requires what may be an unobtainable level of security, or at least a standard that cannot be met. Since the CAT data is housed outside the SEC, an alternative would be to allow the SEC to access the data from within the CAT system itself, not a government computer system. Without this refinement, we oppose the bill.

Conclusion

With these bills, the House Financial Services Committee ignores the constituents who sent them to Congress. Americans want strong Wall Street rules. They want strong consumer protections. Instead, the committee is servicing a sector that's made substantial political contributions. These contributions are made possible by the high fees and scams that the banking sector extracts from the very citizens that the committee should otherwise seek to protect.

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

Sincerely,

Public Citizen