Center for American Progress

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Chairman Jeb Hensarling
Ranking Member Maxine Waters
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

We are writing to express concern about many of the 23 pieces of legislation that the House Financial Services Committee will mark up this Wednesday, October 11, and to urge Committee members to scrutinize these bills carefully to determine whether they are, in fact, necessary and beneficial to the functioning of our nation's financial system.

As you are aware, many of the provisions scheduled for markup this week were already contained in the CHOICE Act, which passed the House earlier this year. As we wrote in our April 2017 report, "President Trump's Dangerous CHOICE," the CHOICE Act thoroughly demolishes critical financial reforms and would leave America facing bigger booms and busts, greater concentration of economic power, and less accountability for financial wrongdoing – all of which damage the increasingly fragile U.S. economy and destroy jobs and livelihoods.[1] Sadly, these provisions are mostly solutions in search of problems. Lending has rebounded since the financial crisis.[2] Financial institutions, including community banks, are as profitable as ever, with FDIC-insured institutions reporting a 10.7 percent increase in aggregate net income in the second quarter of 2017 as well as the highest average return on assets in ten years.[3] And the capital markets are experiencing record highs in bond issuance and strong liquidity.[4]

The CHOICE Act was passed rapidly, without a full and fair hearing on the numerous provisions contained therein. The Committee's interest in reviewing and discussing individual provisions at this week's markup is a positive development, but curious given that most of these measures have already passed the full House. Hopefully, this markup will provide the Committee the

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[1] Gregg Gelzinis and others, "President Trump's Dangerous CHOICE" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/04/19/430601/president-trumps-dangerous-choice/.
[2] Gregg Gelzinis and others, "The Importance of Dodd-Frank, in 6 Charts" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/news/2017/03/27/429256/importance-dodd-frank-6-charts/.
[3] Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Second Quarter 2017", Volume 11, Number 3 (2017), available at https://www.fdic.gov/bank/analytical/quarterly/2017-vol11-3/fdic-v11n3-2q2017.pdf.
[4] Andy Green and Gregg Gelzinis, "Phantom Illiquidity: A Closer Look Reveals that the Bond Markets Are Functioning Well" (Washington; Center for American Progress, 2016), available at https://www.americanprogress.org/issues/economy/reports/2016/11/15/292313/phantom-illiquidity-a-closer-look-reveals-that-the-bond-markets-are-functioning-well/.

opportunity to reconsider its approach as scrutiny of these measures suggests that by and large, they are unwarranted. Sadly, the broad thrust of the 23 bills flatly fails to provide the tougher rules and stronger enforcement on Wall Street that the vast majority of Americans want[5], but instead enshrines new exemptions and giveaways. We urge reconsideration.

While not an exhaustive list of comments on the bills being marked up this week, we would like to raise the following concerns, grouped by broad categories of legislation.

Regulatory Reform Bills Broadly Exempt Large Financial Institutions from Accountability and Weaken Safeguards

- **H.R. 1116, the TAILOR Act of 2017**, directs federal financial regulators toward tailored rulemaking for financial institutions. While a laudable goal, this bill ignores the existing tailoring of regulation by institution type and size.[6] Instead, it gives regulatory agencies a broad brush to exempt virtually any institution they please—the type of broad discretion that let regulators be asleep at the switch in the years leading up to the financial crisis. Meanwhile, it imposes new requirements to minimize regulatory costs without concern for the benefits of regulation[7] and, by mandating a seven-year lookback period under which regulators would be required to reconsider existing rules, completely undermines the regulations enacted under the Dodd-Frank Act, the Credit CARD Act, and other laws.
- **H.R. 2706, the Financial Institution Customer Protection Act of 2017**, prohibits a federal banking agency from directing a depository institution to terminate an account, absent a material reason. This bill sounds deceptively attractive, but is both unnecessary and dangerous. It is unnecessary because the idea that regulators are indiscriminately ordering banks to close accounts is a fiction. Banks engaged in distant, out-of-state operations with unknown third parties are failing an essential tenet of good banking: knowing one's customer. Even with the bill's national security exemption, it would encourage race-to-the-bottom banking operations that expose the American people to risks of terrorist financing, money-laundering, fraud, and general illegal activity, including high cost short-term loans illegal under various state laws.
- **H.R. 3072, the Bureau of Consumer Financial Protection Examination and Reporting Threshold Act of 2017**, raises the Consumer Financial Protection Bureau, or CFPB, examination and reporting requirements thresholds of insured depository institutions and credit unions from $10 billion to $50 billion in assets. Financial institutions holding between $10 billion and $50 billion in assets comprise two-thirds of the nation's top 120 banks and credit unions; these are not small institutions and do not need another carveout.

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[5] Joe Valenti, "Please Stand Up If You Support Financial Deregulation" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/news/2017/05/02/431613/please-stand-support-financial-deregulation/.

[6] For example, David Sanchez, Sarah Edelman, and Julia Gordon, "Do Not Gut Financial Reform in the Name of Helping Small Banks" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/reports/2015/07/07/113119/do-not-gut-financial-reform-in-the-name-of-helping-small-banks/.

[7] Joe Valenti and Rebecca Buckwalter-Poza, "Who Pays for Rolling Back Regulations?" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/news/2017/03/13/428049/pays-rolling-back-regulations/.

- **H.R. 3312, the Systemic Risk Designation Improvement Act of 2017**, exempts all but a handful of the largest banks from the tailored enhanced supervision and prudential regulations put in place by the Dodd-Frank Act. Currently, banks with over $50 billion in assets—roughly 40 out of the 6,000 banks in the U.S.—must face stress testing, file living wills with regulators, are subject to enhanced risk management standards, and face stronger capital and liquidity requirements.[8] This legislation would tie regulators' hands and only allow regulators to apply these sensible safeguards to the exempted banks after undertaking a long designation process that requires a two-thirds vote of all financial regulators on the Financial Stability Oversight Council, including the affirmative vote of the Treasury Secretary. Secretary Mnuchin and the other Trump-appointed financial regulators are unlikely to exercise this authority and this process would simply tie the hands of future administrations and regulators. Removing common-sense, tailored financial stability safeguards from banks with roughly $4 trillion in combined assets makes our financial system more vulnerable to another financial crisis.
- **H.R. 3971, the Community Institution Mortgage Relief Act**, exempts lenders and servicers from important consumer protections. As with many of the other so-called regulatory relief bills, this measure casts an all-too-wide net, exempting any creditor with assets of $25 billion or less from certain escrow requirements as long as they hold the mortgage in portfolio for three years. The bill also carves out mortgage servicers managing 30,000 or fewer mortgage loans from a slew of important consumer safeguards.
- **H.R. 2121, Pension, Endowment, and Mutual Fund Access to Banking Act,** changes the calculation of the Supplementary Leverage Ratio, or SLR, for custodial banks by removing cash held at central banks from the leverage ratio's denominator. The SLR, which only applies to banks with over $250 billion in assets, was one of the two key capital requirements adopted in the Basel III international agreement, and subsequently by U.S. regulators, to address the severe undercapitalization of the banking sector. The SLR is not risk-sensitive and thus compliments risk-weighted capital requirements that at times can be gamed by banks, might be improperly calibrated by regulators, and provide incentive to employ significant leverage.[9] This legislation undermines the principle of the leverage ratio by essentially assigning a 0% risk weight to a category of assets for custodial banks. Chipping away at the principle of the leverage ratio, as the Systemic Risk Council argues, is likely to be the "thin edge of a thick wedge."[10] Any changes to the capital requirements of systemically important custodial banks should revolve around the interaction between the top-line numbers for their risk-weighted capital requirements and their SLR requirements, not around the calculations themselves.

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[8] The Federal Reserve Board applies these enhanced standards in an appropriately tailored manner, with the most stringent standards applying to the largest, most systemically important banks. Smaller, less complex banks face less burdensome versions of these enhanced requirements and several requirements do not apply at all to banks under $250 billion in assets.

[9] Gregg Gelzinis, "Treasury wants to weaken a crucial post-crisis capital requirement," *American Banker*, June 20, 2017, available at https://www.americanbanker.com/opinion/treasury-wants-to-weaken-a-crucial-post-crisis-capital-requirement.

[10] The Systemic Risk Council, "Re: A Financial System that Creates Economic Opportunities: Banks and Credit Unions," Letter to Secretary Steven T. Mnuchin, September 19, 2017, available at https://4atmuz3ab8k0glu2m35oem99-wpengine.netdna-ssl.com/wp-content/uploads/2017/09/SRC-Comment-Letter-to-Treasury-Department.pdf.

- **H.R. 2148, Clarifying Commercial Real Estate Loans,** restricts banking regulators' ability to require higher capital for high volatility commercial real estate, or HVCRE, exposure. This legislation would create a carveout for a segment of these risky HVCRE exposures. No economic evidence has been proffered to suggests that a change in the treatment of HVCRE exposures is warranted. More broadly, providing special-interest carveouts to capital charges are deeply troubling, as risk-weighted capital should be based on economic analyses of actual risks to banks, not political power in Washington. This carveout is especially troubling given a president who maintains personal interests and family connections to a range of commercial real estate ventures. And, at a time when bank capital requirements are already too low, this is not an appropriate change. Regulators' hands should not be tied by these special-interest carveouts.

Securities Bills Erode Investor Protections, Open Doors to Evasive Practices in Capital Formation

- **H.R. 477, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017**, exempts from SEC registration certain mergers and acquisitions brokers. Calling this a "small business" bill is at minimum a misnomer. Not only is the threshold of exemption reaching privately held companies with gross revenues up to $250 million—more than six times the Small Business Administration's highest industry-based receipts standard for what constitutes a small business.[11] But exemption from registration for those structuring the sale of these businesses could actually expose the businesses *themselves* and the investors and potential investors in those businesses to fraud.
- **H.R. 1585, the Fair Investment Opportunities for Professional Experts Act**, expands the definition of an accredited investor. Two of the proposed categories appear reasonable: those holding a current securities-related license, and those for whom the SEC has determined have demonstrable education or job experience to be investment professionals, could both logically be considered qualifying as accredited investors. But locking into statute specific levels of income or net worth that meet the definition of an accredited investor would be a serious mistake. Net worth requirements often capture near-retirees and retirees.[12] These are the very populations who are at the greatest risk for being sold risky, inappropriate, or overpriced investment products that lead them to financial ruin. In the words of one financial advisor, "The [accredited investor] rule is there for a reason, as a safeguard to manage folks' emotions and prevent one's momentary euphoria at a dinner seminar in a fancy

[11] According to the Congressional Research Service, the SBA had 16 receipts-based industry size standards as of April 21, 2016, ranging from $0.75 million to $38.5 million. See Robert Jay Dilger, "Small Business Size Standards: A Historical Analysis of Contemporary Issues," (Washington: Congressional Research Service, 2017), available at https://fas.org/sgp/crs/misc/R40860.pdf.

[12] According to the 2016 Survey of Consumer Finances, the highest mean family net worth of any age group is $1.17 million for household heads age 55 to 64, closely followed by $1.07 million for households headed by someone older than 64. While the median net worth is far lower—peaking at $264,800 for household heads over 75—this suggests that potential "accredited investors" by net worth are concentrated among older Americans. Jesse Bricker and others, "Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, Volume 103 Number 3 (September 2017), available at https://www.federalreserve.gov/publications/files/scf17.pdf.

steakhouse."[13] The SEC needs to retain its traditional discretion to tailor its exemptions from standard investor protections to those who truly should be exempted to make adjustments when needed. Moreover, by further expanding the pool of capital available for private offerings, the bill runs directly contrary to the effort to encourage more companies to go public.

- **H.R. 1645, the Fostering Innovation Act of 2017**, exempts certain public companies from auditor attestation requirements regarding a company's internal controls and procedures for financial reporting. This legislation creates a new carveout for Sarbanes Oxley Section 404(b) requirements to exempt companies that recently ceased to be Emerging Growth Companies, but have annual gross revenues of less than $50 million. Further erosion of financial reporting protections crucial to investors is unwise. Investors in public companies deserve reliable financial information. Weakening these protections exposes investors to unnecessary losses and leaves a larger share of our public markets vulnerable to fraudulent financial reporting.
- **H.R. 2201, the Micro Offering Safe Harbor Act,** would exempt certain micro-offerings from SEC registration requirements. By eliminating regulatory requirements for investors who have a "pre-existing relationship" with an officer, director, or major shareholder of the issuer, this bill has the potential to accelerate the practice of affinity fraud. Personal relationships are no substitute for financial sophistication or regulatory accountability.
- **H.R. 3911, Risk-Based Credit Examinations Act**, would water down the annual SEC examinations of credit rating agencies. By law, regulators must examine several aspects of a credit rating agency's operation annually—including its policies on ethics, conflicts of interest, governance, and more. By endorsing the examination of only those aspects that the SEC deems "appropriate," this legislation would endorse hands-off supervision by the SEC.
- **H.R. 3903, Encouraging Public Offerings Act**, would expand JOBS Act confidential filing and "test the waters" provisions to all filers. Initial studies from the JOBS Act suggest these were some of the more successful provisions therein. However, authorizing these changes on a permanent basis for all filers without sufficiently providing the SEC with the ability to make adjustments or otherwise change course is unwise. A pilot program or time-based study may be more prudent.
- **H.R. 3948, Protection of Source Code Act,** would block the SEC from obtaining source code (e.g. algorithms) from market participants unless they issue a subpoena. This legislation is overbroad and, as drafted, unwise, because it essentially limits SEC review of source codes to enforcement contexts. But in an era of fast-moving, "flash crash"-prone markets, the SEC may have a wide range of regulatory reasons for why it may need to examine source codes, including approvals of new trading products or the supervision of trading venues. The SEC should only exercise that authority carefully and under the strictest protections for confidential information, but blocking it by law dangerously limits the SEC's ability to address the significant technology-based challenges to financial markets.
- **H.R. 3973, Market Data Protection Act of 2017**, would delay the implementation of the Consolidated Audit Trail, or CAT, until each of the SEC, FINRA, and the operator of CAT develop comprehensive internal risk controls to protect market data. While this may sound

[13] Rose Swanger, quoted in Jeff Benjamin, "Financial advisers bristle at SEC's pitch to redefine 'accredited investor'," *InvestmentNews*, February 27, 2017, available at http://www.investmentnews.com/article/20170227/FREE/170229935/financial-advisers-bristle-at-secs-pitch-to-redefine-accredited.

attractive, the bill eliminates SEC control and accountability for the CAT and delays implementation, given significant foot-dragging to date, potentially indefinitely. The CAT is the SEC's most important response to the series of "flash crashes" that continue to roil markets. Ensuring the CAT has appropriate protections for sensitive market data is essential, but creating a byzantine, unaccountable process is not the way to do that.

Anti-Consumer Protection Bills Expand Access to Predatory Lending and Improper Financial Advice While Taking Away Regulatory Tools Targeting Abusive Practices

- **H.R. 1699, the Preserving Access to Manufactured Housing Act**, would exempt manufactured home retailers from various provisions of the Truth in Lending Act and take away protections from buyers of manufactured homes. This bill would allow lenders to charge higher interest rates and fees to consumers without triggering enhanced consumer protections designed to protect borrowers who are taking out high-cost loans. As a result, buyers of manufactured homes would pay a higher interest rate or more fees than buyers of site-built homes before receiving the same protections. Manufactured housing can be an affordable and cost-effective means to expand homeownership for Americans of modest means. However, this market has been prone to significant abusive lending practices that make such loans especially risky for vulnerable borrowers—including low-income households, seniors, and those in rural communities. Potential homebuyers deserve the benefits of a robust housing finance market with strong standards for both manufactured and site-built homes, not one in which manufactured housing lenders are shielded from accountability as this bill would do.
- **H.R. 2954, the Home Mortgage Disclosure Adjustment Act**, would exempt from updated reporting requirements any institution that has originated fewer than 500 mortgage loans and 500 open-ended lines of credit in each of the last two years. While on its face this appears to be a simple regulatory relief bill, this provision would exempt the majority of mortgage lenders from the new Home Mortgage Disclosure Act reporting requirements. Home Mortgage Disclosure Act reporting is the primary source of information on the availability and quality of mortgage lending, and serves a vital function in fair lending assessments. This bill would effectively paint an incomplete or inaccurate picture of lending activity in communities across the country, making it vastly more difficult for regulators and researchers alike to assess the state of the mortgage market.
- **H.R. 3299, the Protecting Consumers Access to Credit Act**, responds to the recent *Madden v. Midland Funding* decision in the Second U.S. Circuit Court of Appeals by statutorily enforcing the doctrine of "valid when made" with regard to state usury caps on bank loans. This bill is not actually targeted at lending by banks. Instead, it would encourage the broader use of "rent-a-bank" models in which a nonbank entity, such as a payday lender, operates through a national bank in order to evade state rate caps.[14] As twenty state Attorneys General stated in a letter to the House of Representatives opposing the CHOICE Act earlier this year, "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

[14] For example, Susanna Montezemolo, "Payday Lending Abuses and Predatory Practices," in Center for Responsible Lending, "The State of Lending in America & its Impact on U.S. Households," September 2013, available at http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf.

caps."[15] Federal and state regulators alike have attempted to rein in these lending practices in the name of national banks——risky and predatory loans that banks itself would likely face scrutiny for making—yet this bill would allow them to flourish.

- **H.R. 3857, the Protecting Advice for Small Savers Act**, would repeal the Department of Labor's fiduciary rule in place of a weaker standard under the Securities and Exchange Commission. This bill ignores the thorough and comprehensive effort by the Department of Labor to carefully construct a conflict of interest rule for retirement investment advice, as well as DOL's role overseeing retirement insurance products under ERISA—a role outside of the SEC's purview.[16] Instead, it legally mandates a variation on the weaker and outdated "suitability" standard that DOL's rule intended to address, while precluding the Department of Labor, Department of the Treasury, and state governments from adopting any additional requirements. Meanwhile, as testing has demonstrated, new disclosure provisions under this bill could still keep even savvy investors confused and uninformed.[17]

Instead of continuing to push for these and other deregulatory measures that are both largely unnecessary and unpopular among the American people, we encourage the House Financial Services Committee to consider legislation that would move the nation closer to a fair, vibrant, yet accountable financial system. Thank you for your consideration of this matter. If you have any questions or would like to discuss any of these concerns in greater detail, do not hesitate to contact us.

Sincerely,

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[15] Letter from Eric T. Schneiderman et. al., June 7, 2017, available at https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.
[16] Barbara Roper, "Wagner Bill Gets It Backwards: SEC Should Follow DOL's Lead on Fiduciary Duty," *Huffington Post*, September 29, 2015, available at https://www.huffingtonpost.com/barbara-roper/wagner-bill-gets-it-backw_b_8215732.html
[17] Angela A. Hung and others, "Investor and Industry Perspectives on Investment Advisers and Broker-Dealers," RAND Institute for Civil Justice, 2008, available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf