A LEGISLATIVE PROPOSAL TO CREATE HOPE AND OPPORTUNITY FOR INVESTORS, CONSUMERS, AND ENTREPRENEURS—DAY 2

HEARING

BEFORE THE

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A LEGISLATIVE PROPOSAL TO CREATE HOPE AND OPPORTUNITY FOR INVESTORS, CONSUMERS, AND ENTREPRENEURS—DAY 2

Friday, April 28, 2017

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 9:20 a.m., in room 2128, Rayburn House Office Building, Hon. Trey Hollingsworth presiding.

Members present: Representatives Messer, Williams, Hill, Tenney, Hollingsworth; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Foster, Kildee, Delaney, Sinema, Beatty, Heck, Vargas, Gottheimer, Gonzalez, Crist, and Kihuen.

Mr. HOLLINGSWORTH [presiding]. Good morning. The Committee on Financial Services will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

This is a continuation of the hearing entitled, "A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs."

The Chair now recognizes the ranking member of the committee, the gentlelady from California, Ms. Waters, for 4 minutes for an opening statement.

Ms. WATERS. Thank you, Mr. Chairman.

And thank you to the witnesses for joining us today, especially Senator Elizabeth Warren, who created the idea of the Consumer Financial Protection Bureau (CFPB) and gave the force behind it to make it a reality. And later, she helped to organize the CFPB. We were all supportive of her becoming the Director, but thank God she is now the Senator from Massachusetts.

Earlier this week the Majority held a hearing during which their witnesses shared so many alternative facts, that I was sure they must be living in an alternative reality.

Today, Democrats are going to set the record straight. We have asked for this second hearing to hear from experts and well-informed witnesses who know, understand, and appreciate the importance of the Dodd-Frank Wall Street Reform and Consumer Protection Act and who can point out the dangers of the "wrong choice act." The chairman's wrong choice act destroys Wall Street reform, guts the Consumer Financial Protection Bureau, and returns us to

the financial system that allowed risky and predatory Wall Street practices and products to crash our economy.

We all remember the dark days of the financial crisis and the Great Recession, the 11 million Americans who lost their homes to foreclosure, the $13 trillion in household wealth that went up in thin air, the 10 percent unemployment rate, and the many retirements deferred.

This bill would erase all of the progress we have made since then and put us on the road back to economic ruin. It is not just a bad bill, it is an expansively bad bill with repercussions for our whole country.

Astonishingly, the chairman had only planned a single hearing on the wrong choice act. Democrats held 41 hearings in this committee to consider the House version of Dodd-Frank before its passage. It was a transparent, open process that carefully considered a variety of perspectives to ensure a sensible, well-considered set of reforms. The Republican approach stands in stark contrast.

The fact that the Majority planned to hold just one hearing before rushing a nearly 600-page bill to markup sure makes it look as if they were trying to hide something. It must be that they realized that the optics of this Wall Street giveaway bill were pretty bad and hoped the American people were not paying attention.

I am going to yield the balance of my time to Mr. Kildee.

Mr. KILDEE. Thank you to the ranking member for yielding and for arranging for this really important hearing. And I welcome our witnesses, all of them, particularly Senator Warren. I appreciate all the great work that you have done on this particular subject.

This act, the Financial CHOICE Act, kills so many of the important Wall Street reforms that this Congress enacted as a result of the crisis and, in fact, takes us back to a time when policies allowed and, in fact, policy encouraged banking practices that wrecked the economy and caused millions of Americans to lose their homes. That was the focus of my work before I came to Congress, so I have seen this firsthand.

Policy is what caused that crisis. It created an environment that allowed institutions to take advantage of families, take advantage of individuals, and cause them to lose everything they have worked for. And what I saw in the work that I did in my hometown of Flint, Michigan, and all around the country was the consequence of that policy. A single abandoned home as a result of a foreclosure is like a contagious disease. It infects an entire community, it reduces the value of every home, and it wrecks whole neighborhoods.

What this Financial CHOICE Act does would be to reinstate the very policies that precipitated that crisis and all that pain, and we need to fight it in every way that we can. And I thank you for your willingness to join in that battle.

With that, I yield back.

Mr. HOLLINGSWORTH. The gentlelady's time has expired, and the gentleman yields back.

Today, for our first panel, the committee will receive the testimony of Senator Elizabeth Warren. Senator Warren is a United States Senator representing the Commonwealth of Massachusetts. Before being elected to Congress, Senator Warren was the Leo

Gottlieb Professor of Law at Harvard Law School. She is a graduate of the University of Houston and the Rutgers School of Law.

Senator, you will be recognized for 5 minutes to give an oral presentation of your testimony.

Senator Warren, you are now recognized.

STATEMENT OF THE HONORABLE ELIZABETH WARREN, A UNITED STATES SENATOR FROM THE STATE OF MASSACHUSETTS

Senator WARREN. Thank you, Mr. Chairman. And thank you, Ranking Member Waters, for holding this hearing and for giving me a chance to speak about the CHOICE Act.

Let me be blunt. This is a 589-page insult to working families. It would immediately increase the cost of mortgages, student loans, and small businesses. This bill would let big banks and payday lenders and financial advisers go back to cheating people, with no accountability, and it would unleash the same behavior on Wall Street that led to the 2008 financial crisis.

When I read this bill, I think why, why, just 8 years after the worst financial crisis in more than 70 years, are Republicans lining up to roll back the rules on Wall Street and make it easier for financial firms to cheat people? Why, just 6 months after the American people elected a Republican President, who claimed he would take on Wall Street and drain the swamp, are Republicans in Congress moving in literally the opposite direction? What exactly is the problem that they think they are trying to solve?

So here are the arguments I usually hear. Our new rules have made it too hard for banks to lend money. Really? Check the facts. Access to consumer credit and small business lending is at historically high levels, and loan growth at community banks is up even more than at big banks.

Here is another one: We have made compliance so difficult that banks just can't operate. Nope. That one's not true either. Banks of all sizes posted record profits last quarter, with profits at community banks up even more than at the big banks.

And here is the last argument I hear. We are making it hard for our bigger banks to compete internationally. Wrong again. Our big banks are blowing away their foreign competitors.

This bill doesn't solve a single real problem with the economy or with our financial system, but it does make some big time lobbyists happy.

I have heard the Democrats on this committee calling this bill the wrong choice act, and, boy, is that true. It is the wrong choice. Wrong choice? No. It is an immoral choice. It is about throwing working families under the bus so that Congress can do the bidding of Wall Street.

Shortly after the financial crisis hit, I remember going to Clark County, Nevada, for a hearing to listen to just a few of the millions of people whose lives were being torn apart by the crisis. A man named Mr. Estrada showed up to tell his story. He and his wife both worked hard, and they had stretched their budget to buy a house that was right across the street from a really good school for his two little girls, but the Estradas had a mortgage with an ugly surprise buried in the fine print. When the payments jumped, they

fell behind, and Mr. Estrada and his wife talked to the bank over and over, and they thought they had arranged a modification; then, poof, the house was sold at auction, and the bank gave his family 14 days to move out, to move those two little girls out of their home.

Mr. Estrada told us that after they got the notice, his 6-year-old came home with a sheet of paper with all her friends' names on it, and she told him that this was her list of the people who were going to miss her, because her family was going to have to move. He said he told his daughter, "I don't care if we have to live in a van. You are going to be able to go to the school."

And as he told this story, Mr. Estrada, a big man, stood there in front of a room full of strangers and tried not to cry.

Now, that is a story that was shared by Americans all across the country, people in each of the districts that you represent.

We built the Consumer Financial Protection Bureau and the rest of Dodd-Frank so that Mr. Estrada and other families like his wouldn't get cheated and wouldn't face that kind of pain again.

You know, some banks like to say, "We didn't cause the crash," but let's be clear, Mr. Estrada didn't cause the crash either, but, boy, did he pay a price for it. We have an obligation, a moral obligation to make sure that kind of crisis never happens again in this country; that is why voters sent us to Washington, to work for them, not for a bunch of high-priced Wall Street lobbyists.

I hope you will think hard about Mr. Estrada and about the millions of people like him when you consider this legislation.

Thank you again for inviting me here to testify today.

Mr. HOLLINGSWORTH. Senator Warren, thank you for your testimony. Pursuant to customary practice for Members of Congress, you are excused, and the second witness panel will be seated.

Senator WARREN. Thank you.

[recess]

Mr. HOLLINGSWORTH. The committee will come to order.

We now turn to our second panel of witnesses, whom, in the interests of time, I will introduce briefly.

Corey Klemmer, corporate research analyst, Office of Investment, AFL-CIO; Reverend Willie Gable, Pastor, National Baptist Convention, USA; John Coffee, Adolf A. Berle Professor of Law, Columbia University; Rob Randhava, senior counsel, Leadership Conference on Civil and Human Rights; Melanie Lubin, Maryland Securities Commissioner, on behalf of the North American Securities Administrators Association.

Emily Liner, Senior Policy Advisor, Economic Program, Third Way; Amanda Jackson, outreach coordinator, Americans for Financial Reform; Ken Bertsch, executive director, Council of Institutional Investors; Sarah Edelman, director, housing policy, Center for American Progress; and Rohit Chopra, senior fellow, Consumer Federation of America.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, any written statement that you may have will be made a part of the record.

Ms. Klemmer, you are now recognized.

STATEMENT OF COREY KLEMMER, CORPORATE RESEARCH ANALYST, OFFICE OF INVESTMENT, AFL-CIO

Ms. KLEMMER. Good morning. As you said, my name is Corey Klemmer. I am here on behalf of the AFL-CIO and our over 12½ million members. I thank you for the opportunity to address the committee, but I wish it were under different circumstances.

This bill is nothing short of a complete attack on American workers. U.S. workers are the U.S. economy. We provide the labor that drives productivity, we are the consumers who provide demand, and as retirement savers, we are significant investors.

The economy has not been great to us. Real wages have been stagnant for decades, while prices continue to rise. After wildly speculative and unregulated financial activity brought us the collapse of 2008, working Americans paid the price, losing millions of jobs, millions of homes, and trillions in retirement assets.

Today, workers continue to recover slowly, while the country has made modest but vital progress in implementing commonsense reforms. The financial actors who got rich driving the economy to collapse have gotten tired of playing by the rules and would like to return to the casino of, "heads, I win; tails, you lose," and this act aims to deliver just that.

The level of Orwellian double speak is remarkable in this bill. The title stands for creating hope and opportunity for investors, consumers, and entrepreneurs, while the act simultaneously seeks to eviscerate the rights and protections and economic stability on which each of those groups depend.

First, investors need information and faith in the markets. U.S. capital markets are attractive because they have both: a reliable system of disclosure, however limited; and a robust and mature legal framework that has been in place in some cases for nearly a century. Yet, this act undoes some of the most fundamental components of those structures. It also essentially undoes the fiduciary rule, which requires financial actors to act in the interests of their clients, and would save retirement savers an estimated $17 billion a year.

It also, incredibly, removes the reporting requirements for private equity, which in the short time that they have been required have uncovered incredible and significant fraud and improper fees. All of this represents less accountability and less transparency in our markets.

Second, the act would expose consumers to risky and complicated financial products without warning, blame consumers who are preyed upon by financial actors exploiting informational and power asymmetries, and stop the government from overseeing or regulating these transactions.

I will leave it to the other panelists to get into the details, but suffice it to say, for all the talk of accountability, the act explicitly seeks to undermine the tangible successes in transparency and accountability brought about since 2008.

Finally, the act attacks working Americans and entrepreneurs, for that matter, by threatening financial stability and effectively preventing government from exercising essential control or oversight of the industry that took our economy to the brink of complete failure. It enables Wall Street to do precisely the things that

brought about the crisis: speculating with federally-insured deposits; rewarding risk-taking executives with lavish bonuses; facilitating the unregulated flow of products that caused contagion; and further enabling the consolidation of too-big-to-fail institutions, just to name a few things.

It also decimates the role of financial regulatory bodies, introducing the dysfunction of Congress and the politics of the appropriation process into independent and executive agencies. For example, under the act, the Federal Reserve would lose one of its most important tools in fulfilling its duel mandate to promote full employment and stable prices: setting interest rates.

By tying interest rates to a version of the Taylor Rule, the act would have rates set mechanically, limiting the ability of the Fed to respond dynamically to changing circumstances. According to estimates from the Minneapolis Fed, had this rule been in place during the crisis, it would have resulted in the loss of an additional 2.5 million jobs.

If 2008 should have taught us anything, it is that a blind fidelity to an elegant theory or formula to the exclusion of evidence and common sense is not good for markets and it is not good for people. Financial markets are not linear or static, and they do not conform to formulas no matter how sophisticated or clever. Markets are complex and dynamic ecosystems that require high-level analysis and thoughtful governance. The total abdication of control to the markets, as advocated for in this bill, is its own decision. It is a failure of governance and it is a failure to all Americans.

Thank you, and I will be happy to answer any questions later.

Mr. HOLLINGSWORTH. Reverend Gable, you are now recognized.

STATEMENT OF REVEREND WILLIE GABLE, JR., PASTOR, PROGRESSIVE BAPTIST CHURCH, NEW ORLEANS, LA; AND CHAIR, HOUSING AND ECONOMIC DEVELOPMENT COMMISSION, NATIONAL BAPTIST CONVENTION USA, INC.

Rev. GABLE. Thank you, Mr. Chairman, and Ranking Member Waters. Thank you for inviting me and the other panelists here.

I am Reverend Willie Gable, Junior, and I serve as Pastor of the Progressive Baptist Church in New Orleans, Louisiana. My congregation is a member of the National Baptist Convention, USA, Inc., the Nation's largest predominantly African American religious denomination.

I am also the Chair of the Housing and Economic Development Commission of the National Baptist Convention. This commission's mission is to provide affordable housing for low- and moderate-income persons, particularly senior citizens and the disabled, allowing them to live in a place they can call home. Over 20 years, the commission has developed over 1,000 homes in 30 housing sites in 14 States. I also serve as the co-Chair of the Faith and Credit Roundtable, and I am a member of the Faith for Just Lending Coalition.

I am here today before you to discuss the utter devastation that predatory financial practices have wrought on my community and on communities across this Nation, and also to talk about the safer market we have now that newly implemented and reasonable CFPB rules are coming into place. I also want to talk about the

desperate need for further regulatory actions to weed out the abhorrent financial abuses in other product areas that continue to this day.

The CHOICE Act, unfortunately, would take us back, when we desperately need to continue to move forward. The CHOICE Act contains many dangerous provisions, I believe, that would take us back to the unchecked practices that caused the Great Recession of 2008, but today, I will specifically address a provision in the bill that would bar the Consumer Financial Protection Bureau (CFPB) from regulating payday lenders and car title lenders.

These triple digit, unaffordable payday, car title, and high-cost installment loans dig borrowers into a deeper hole of debt than they were when they began. As these types of loans are specifically aimed at low-income communities and communities of color, it is imperative, I believe, that we support the CFPB's efforts to put an end to this predatory practice on poverty. To be true about it, it is no more than legalized loan sharking and it is a way of pimping the poor for a profit.

In my home State of Louisiana, payday lending makes loans to 57,000 Louisianans each year. In my community, we often encounter elderly individuals who have taken out payday loans. The younger family members often don't learn about it until they are caught up in the deep trap. And it is not surprising, because payday loans are considered shameful, or kept in secret, and many individuals feel shame about it.

Also in my State, and certainly in others, there are more than 4 times as many payday loan storefronts as McDonalds, and for some strange reason, they concentrate themselves in African American communities.

Now, I do not believe that this is an indication that people need or desire payday loans in our communities. The most common reason people need a payday loan is because of a specific crisis that occurs. It is not to buy flat screen TVs, but because an emergency comes up. But what these loans do is pull them into a cycle, by design, to so-called demand that generates and feeds itself. It is an intentional exploitation of the desperate.

Just in our congregation, I had a member who came to me and told me that her mother, who was in the precursor areas of Alzheimer's, had four payday loans. She is in the early stages of Alzheimer's, and yet they preyed on her, and we have to work with that daughter to get her mother out of those loans. She is just one example, and yet we have benevolence funds, but we are underwriting payday lenders, because members of our congregation are too ashamed to let us know that they have a payday loan, they bring us a copy of their utility bill. And so we are not saying that we don't want to help, but we are not certainly going to undergird them.

In 2015, a diverse group of faith organizations formally came together to establish Faith for Just Lending, a national coalition that shares the belief that scripture speaks to the problem of predatory lending. Our coalition condemns usury and exploitation of the financially vulnerable. Fortunately, the Consumer Protection Bureau also works to prevent these deceptive traps of banks, payday lend-

ing, credit cards, and debt collection, and many other financial product services. We support the work that they are doing.

And I look forward to answering any other questions that you may have.

[The prepared statement of Reverend Gable can be found on page 81 of the appendix.]

Mr. HOLLINGSWORTH. Professor Coffee, you are now recognized.

STATEMENT OF JOHN C. COFFEE, JR., ADOLF A. BERLE PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL

Mr. COFFEE. Thank you, Mr. Chairman, Ranking Member Waters, and members of the committee.

Time is short, and everybody wants to talk, so I am going to use a style that all law professors know as the "bikini" style of law teaching. Under the bikini style, you cover the critical points, but only just barely.

And with that preface, let me tell you that the CHOICE Act unnecessarily and recklessly exposes the American economy and the American people to a serious risk of a major financial crisis that could be as severe or greater than the 2008 crisis. It does so in at least seven distinct ways, in each case unraveling an elaborate provision that was adopted by Dodd-Frank or used during the 2008 crisis.

I am going to go through those very briefly and then make one comment about the overall impact of this legislation on SEC enforcement. This will devastate SEC enforcement, in my judgment, reducing by a third or more the cases that the SEC can bring in any period. Let's go through these seven ways very quickly.

The first thing that the CHOICE Act does is eliminate the orderly liquidation authority, which was the new innovation of Dodd-Frank. I admit that procedure can be simplified and streamlined, but eliminating it is reckless. In its place is substituted a bankruptcy provision that is basically skeletal.

This has three serious consequences. First, it takes the regulator out of the process in determining whether or not a failing bank should be terminated. The regulator has stress tests, living wills, all kinds of information, but it can't use it, because it can't make the decision to terminate. It is up to the bank to file bankruptcy. That is dangerous, and it will delay the moment at which a failing institution is shut down, because the bank will wait until the last possible moment.

The next thing that this substitution does is eliminate any source of liquidity for a bank that may be facing a liquidity crisis. Most banks don't fail because of insolvency in the classic sense; they fail because of a liquidity crisis. Orderly liquidation authority could solve that liquidity crisis by turning to the Federal Deposit Insurance Company's basic stabilization funds. That is eliminated. And if you take liquidity out of the process, the failure will be worse, longer, and a total shutdown is likely.

Next point. The CHOICE Act turns to a new idea, it is off-ramp. This could be a good idea if it were applied to very small banks, but it doesn't just apply to small banks, it applies it to all banks, big or small, and it gives them a way to escape everything in Dodd-Frank if you can just satisfy one single metric.

That metric is a leverage ratio, which is basically ambitious, but if you tell banks that they can escape all regulation just by satisfying that leverage test, you are going to set off the largest game of regulatory arbitrage that U.S. financial history has witnessed. You are telling banks that they can escape everything if they can just meet this 10 percent leverage test. And that leverage test is simple leverage. Basel III and the rest of the world uses a risk-weighted leverage test. This is not using a risk-weighted leverage test.

The real impact of this provision is that it will encourage banks to shift to riskier assets. If the only standard is a leverage test, you simply meet that test and then move your assets from Treasury Securities to the junior tranche of some exotic securitization.

Other points. The next major failure is the elimination of the Volcker Rule. You have basically heard of the Volcker Rule, but the idea is that banks are too big-to-fail. We have to regulate their risk taking so they don't fail. The Volcker Rule was a reasonable way of doing that, by getting banks out of the business of proprietary trading.

The next thing this statute does is eliminate Treasury's exchange stabilization fund. That sounds very exotic, but the most dangerous moment in 2008 was the moment at which all of the holders of America's money market funds, retail investors, and millions of them, suddenly were getting nervous, suddenly were panicking, and were going to redeem their money market funds. That was staved off when the Treasury turned to the exchange stabilization fund and guaranteed those money market funds. That is not the ideal solution. That is the solution of last resort, but don't throw that last resort out. It saved us in 2008, and not that much has changed in the regulation of the money market funds.

Next big problem: The CHOICE Act will greatly exacerbate the possibility, greatly increase the likelihood of a clearing house failure. Dodd-Frank established clearing houses for over-the-counter securities, and they concentrate risk. Once you concentrate risk, you have to regulate these things. Instead, we are eliminating the financial municipal utility provisions.

The other two provisions, I will leave alone. They are basically the risk retention rules, which limited securitizations. Now it will apply only to residential mortgages and nothing else, and anything that is securitized can be securitized through a originate-to-distribute model, which encourages recklessness and lets you package toxic securities.

My time is running out, so I will just say I have covered all of those provisions. The last one I left out was that we will no longer allow the Financial Stability Oversight Council (FSOC) to ever classify a nonbank as systemically important. I can't see the future, but I do think there is a real chance that sometime in the future, there will be such an institution that needs to be classified as systemically important, just as AIG came out of the blue and suddenly revolutionized our financial system and precipitated a crisis. We can't see the future; we should leave that authority in the FSOC.

In my final seconds—I guess my time is now up, so I will end.

[The prepared statement of Mr. Coffee can be found on page 73 of the appendix.]

Mr. HOLLINGSWORTH. The Chair now recognizes Mr. Randhava.

STATEMENT OF ROB RANDHAVA, SENIOR COUNSEL, LEADERSHIP CONFERENCE ON CIVIL AND HUMAN RIGHTS

Mr. RANDHAVA. Thank you, Mr. Chairman, and Ranking Member Waters. I am Rob Randhava, the senior counsel at the Leadership Conference on Civil and Human Rights. We are a coalition of more than 200 national advocacy organizations, founded in 1950 at the outset of the civil rights movement. And I am also on the steering committee of Americans for Financial Reform and a founding member of the Asset Building Policy Network.

I have to admit that we were torn about being here today. For us, this bill is a nonstarter, and we are concerned about giving it an air of legitimacy that we don't believe it deserves.

We have looked mostly at the parts affecting the CFPB and its policies. There are other witnesses here today, and others who have written in, who could do a much better job than, frankly, I can of getting into the weeds of those parts, as well as the rest of the bill, so I won't try to do that here, but I will say what we think in general about the CFPB and its policies.

We are an organization that for years, before the financial crisis, begged Congress and Federal regulators to put a stop to the deceptive, anything-goes kind of lending that was running rampant in communities of color and everywhere else. Some Members, like former Congressmen Barney Frank and Brad Miller, heard our concerns and tried to push for better regulations, but to a great extent, we were ignored.

And I can't tell you how many times I heard the phrase, "access to credit," being used to justify things like 228 or pick a payment mortgages. So we joined with consumer groups like the Center for Responsible Lending (CRL) when it predicted 2 years before the crisis that there would be a wave of millions of foreclosures, only to hear CRL accused of betting against housing.

So when the crisis did hit, and when some on this committee had the audacity to blame it all on people and groups who had been trying to prevent it, or on the Community Investment Act, you can bet that we were very involved in the effort to try to create a better system with Dodd-Frank. And ever since the CFPB opened its doors, it has worked tirelessly to advance the financial health of the communities we represent, not just carrying out the once radical concept of ability to repay, but trying to address racial discrimination in auto lending markups, sneaky credit card add-ons, and a whole lot of other deceptive and abusive practices.

The CFPB and Director Cordray have done their best to apply the law to bad actors, give clear guardrails to the good ones, and put billions of dollars back in the pockets of consumers who have been ripped off. And at the same time, they have worked to promote consumer education and the growth of more inclusive financial technology.

I am stunned that anyone can be troubled by a record like that, and even more stunned by the intensity of the emotions around this. When we hear the CFPB described as a dictatorship or as a tyranny by some members of this committee, it is that kind of rhetoric—I will just say this: Given our involvement in Dodd-Frank, I

am happy to say that various parts of the industry have engaged the Leadership Conference on consumer finance issues.

We in large banks want to get more people into mainstream banking. We have sided with trade organizations to support flexibility in downpayment requirements. We have teamed up with community banks and lenders on issues surrounding Fannie Mae and Freddie Mac. And we worked with our late friend Bill Bartmann of CFS2 on better debt collection rules. And we have engaged small dollar lenders that have said they can work with the rules being proposed by the CFPB.

And, of course, we have disagreed on things too, but we have been glad to engage the industry, and we would like to do that even more in the future. The CFPB, of course, does the same, all the time. We want the system to work for providers and consumers. And if policies need to be fine-tuned for that to happen, we are all ears, but nobody has engaged us in two-way conversations about a dictatorship or a tyranny at the CFPB.

So when we hear the need for legislation described in those terms, I honestly don't know how to engage the legislation in a serious way. The Leadership Conference was proud of Ranking Member Waters last fall when she described the last year's version of this bill as a charade and declined to drag it out in the markup.

However members handle next week's markup, I would suggest that the real fight over this bill should be in the court of public opinion. Rest assured, the public is not clamoring for this bill. In fact, multiple polls have shown strong bipartisan support for the CFPB's work. And over and over again, the bad apples in the industry keep on writing the talking points for us.

One of the best examples of this was seen in last November's vote on a South Dakota ballot initiative regarding payday lending, to outlaw payday lending. That vote, which was down the ballot, mind you, had almost as much participation as the vote for President, and a whopping 75 percent called for putting an end to the kinds of debt traps that the Financial CHOICE Act would enable.

In other States that voted on payday lending, the results have been the same, and voters haven't been clamoring to go back. So if the supporters of the Financial CHOICE Act want to pick this fight, the Leadership Conference won't hesitate to join in, to continue educating the public and give this bill the pushback it deserves. Thank you.

[The prepared statement of Mr. Randhava can be found on page 115 of the appendix.]

Mr. HOLLINGSWORTH. Votes have been called on the House Floor.

The Chair will recognize Commissioner Lubin for her testimony, after which we will recess for votes and then return.

Commissioner Lubin, you are now recognized.

STATEMENT OF MELANIE SENTER LUBIN, MARYLAND SECURITIES COMMISSIONER, ON BEHALF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Ms. LUBIN. Thank you, Mr. Chairman. Good morning, Mr. Chairman, Ranking Member Waters, and members of the committee.

My name is Melanie Lubin. For the past 30 years, I have worked in the Securities Division of the Maryland Attorney General's Of-

fice, serving as an Assistant Attorney General, and since 1998, as Maryland's Securities Commissioner.

I also represent Maryland within the North American Securities Administrators Association, or NASAA, and currently serve as a member of its board of directors and Federal Legislation Committee.

Since 2015, I have also served as NASAA's nonvoting member on the FSOC. NASAA was organized in 1919 and its U.S. membership consists of the securities regulators in the 50 States, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

I am honored to testify before the committee today about NASAA's views on a legislative proposal introduced Wednesday entitled the Financial CHOICE Act of 2017. Congress enacted the Dodd-Frank Act in July 2010 in response to the 2008 financial crisis. The purpose of the Dodd-Frank Act was to strengthen our financial system and better protect the millions of hardworking Americans who rely on their investments for a secure retirement.

State securities regulators are deeply concerned that if enacted in its current form, the Financial CHOICE Act would detrimentally change regulatory policies and expose investors in securities markets to significant unnecessary risks.

NASAA's full written statement submitted for this hearing addresses 23 provisions in the Financial CHOICE Act. I am happy to discuss any of these provisions. However, I will use the balance of my oral testimony to highlight several elements of the legislation that NASAA considers particularly problematic.

First, Section 391 of the bill includes a provision that attempts to mandate coordination among financial regulators, including the States. While the provisions may appear relatively benign on its face, State regulators are deeply concerned that if enacted, it will impose Washington's red tape and priorities on the States.

Today, coordination between State and Federal regulators is a voluntary process. This process ensures that the jurisdictional reach of the regulators remains unhindered and that harmful conduct is addressed in an efficient manner, without the need to work through Federal bureaucrat obstacles.

Because State securities regulators prioritize protection of retail investors, forcing States to take a back seat during investigations that involve more than one agency would put these mom- and-pop investors more directly in harm's way. We urge Congress to remove the reference to State securities authorities from Section 391.

NASAA's second area of concern involves Section 827 of the bill, a baffling attempt to impose additional procedural hurdles, which would in turn hinder keeping bad actors out of the securities industry. The Dodd-Frank Act took an important step toward reducing risks for investors in private offerings by requiring the SEC to prohibit bad actors from using the Reg D, Rule 506 exemption. Enacting any legislation that would needlessly expose unknowing investors to bad actors would be a grave mistake.

NASAA's next area of concern is Subtitle P, which would enact a wholesale revision of the JOBS Act's crowdfunding provisions less than a year after they took effect. If Congress is poised to enact policies intended to strengthen the economy, this provision will have precisely the opposite effect. Among other things, this provi-

sion would eliminate individual and advocate investment caps, allow an issuer to conduct Federal crowdfunding without a registered intermediary, remove many required disclosures to investors and ongoing reporting to the SEC, and repeal liability provisions that were carefully crafted to apply to the unique characteristics of a crowdfunded offering.

NASAA is also very concerned about provision in Subtitles L and M. Subtitle L creates a new class of security, a venture security, that would be listed and traded on a new venture exchange. These securities would be exempt from a significant number of regulatory requirements, including State registration, and presumably would be subject to significantly diminished listing standards.

Subtitle M would allow the SEC to recognize any exchange of any size or quality as a national securities exchange. All securities listed on these exchanges would be preempted from State registration laws. The benchmark for preemption established by Congress in existing law requires that an exchange have rigorous listing standards, substantially similar to those of the major national stock exchanges, like the New York Stock Exchange.

Allowing an exchange to qualify as a national securities exchange regardless of the quality of the exchange or the quality of its listed securities removes vital investor protections.

The final concern I will discuss is NASAA's opposition to Section 841. NASAA has long supported a heightened standard of care for broker-dealers. Clients expect broker-dealers to act in the client's best interest. This provision would, among other things, invalidate the rule recently adopted by the Department of Labor. It would also effectively prevent the Department of Labor from undertaking any future rulemaking regarding the conduct of broker-dealers in the management of retirement accounts until the SEC completes rulemaking.

The provision would also impose on the SEC unduly onerous requirements for regulatory, analytical, and economic analysis prior to adopting a rule. Ultimately, Section 841 would delay and perhaps prevent any effort to establish a meaningful heightened standard of care for broker-dealers.

Thank you again for the opportunity to testify before the committee. I would be pleased to answer any questions you may have.

[The prepared statement of Commissioner Lubin can be found on page 93 of the appendix.]

Mr. HOLLINGSWORTH. Votes have been called. The committee will reconvene immediately after Floor votes have concluded. Members are advised that this is a two-vote series.

The committee stands in recess.

[recess]

Mr. HOLLINGSWORTH. The committee will come to order.

Ms. Liner is now recognized for 5 minutes.

STATEMENT OF EMILY LINER, SENIOR POLICY ADVISOR, THIRD WAY

Ms. LINER. Good morning, Mr. Chairman, Ranking Member Waters, and members of the committee. Thank you for the opportunity to testify at today's hearing. My name is Emily Liner, and

I am a senior policy adviser in the economic program at Third Way, a centrist think tank in Washington, D.C.

There are many reasons to support the Dodd-Frank financial reform law. The perspective I am going to take is on Dodd-Frank's positive effect on economic growth.

My view and the view of Third Way from studying this law and speaking with dozens of experts in the realm of business and finance is that Dodd-Frank is pro-growth, pro-market, and pro-investor. That is why we at Third Way are concerned that the Financial CHOICE Act would undo the progress that Dodd-Frank has made in making the financial system safer while still preserving its ability to innovate and allocate capital.

Let me take you through why we feel this way.

Let's start with risk-weighted capital. Risk-weighted capital is one of the airbags that protects our banking system from melting down. It requires banks to maintain a sufficient level of equity based on the riskiness of its assets.

Because of Dodd-Frank, risk-weighted capital in the United States banking sector has increased 41 percent since the end of 2009. That means banks are significantly safer. And thanks to the banking watchdogs at the Federal Reserve, the eight biggest U.S. banks are required to have risk-weighted capital above and beyond the industry standard. That keeps banks safe and sound, which is good for growth, for markets, and for investors.

The CHOICE Act, however, repeals risk-weighted capital as well as the liquidity coverage ratio. This will make banks less safe and will at some point cost our economy, undermine growth, and hurt investors.

What makes Dodd-Frank a pro-market law is its focus on risk that could be spread through interconnected financial institutions. Stress tests, for example, are an annual exam of the Nation's largest and most important financial institutions to determine if they could survive a bad recession. It is not an easy test, nor should it be.

Eventually there will be another economic downturn, and we need to be certain that our largest financial institutions can weather the storm so that we can return to growth, return to strong markets, and prevent massive investor losses far more quickly. If we had had stress tests before the financial crisis, we could have been prepared to take action before the chain reaction of bank failures unfolded in 2008.

The CHOICE Act weakens the stress-test exercise by making the penalty on paying out dividends optional for banks that meet its low standard for exemption from the rules. Make no mistake, this will come back to hurt our economy.

Finally, Dodd-Frank is a pro-investor law. The Volcker Rule ensures that American families who participate in the markets as retail investors are protected from harm. Investment bankers can still take risks, but the Volcker Rule prevents that risk from spilling over and hurting innocent people.

During the financial crisis, $2.8 trillion in retirement savings alone evaporated. We owe it to the hardworking Americans who lost the money they spent years scrimping and saving to never let

this happen again. But the CHOICE Act repeals the Volcker Rule as well as other reforms that keep the financial system healthy.

The few safety and soundness standards the CHOICE Act does include, like the 10-percent leverage ratio, are simply not enough to protect the world's largest economy. Under the CHOICE Act's regime, the leverage ratio is the only thing standing between some regulation and no regulation. No one should be comfortable with just one number determining whether banks can opt out of the entire framework for financial safety regulation.

Dodd-Frank is a balanced law that makes banks safer. When banks are safer, we reduce the probability that a crisis will happen. That gives the economy more room to run and grow. According to a cost-benefit analysis of capital and liquidity requirements we performed at Third Way, we find that Dodd-Frank contributes $351 billion to U.S. GDP over 10 years. There is a tangible economic benefit to making the financial sector more stable.

When the economy is humming along, we rarely acknowledge that regulations create a safe environment that allows the economy to expand. But when the economy blows a fuse, it is Dodd-Frank, not the Financial CHOICE Act, that will make sure recessions are short and manageable.

For reasons of economic growth, healthy markets, and investor protection, Third Way opposes this legislation to repeal our strongest financial reforms and replace them with such a weak alternative.

Thank you, and I am happy to answer any questions you may have.

[The prepared statement of Ms. Liner can be found on page 91 of the appendix.]

Mr. HOLLINGSWORTH. Ms. Jackson, you are now recognized for 5 minutes.

STATEMENT OF AMANDA JACKSON, ORGANIZING AND OUTREACH MANAGER, AMERICANS FOR FINANCIAL REFORM

Ms. JACKSON. Members of the committee, thank you for the opportunity to testify today. My name is Amanda Jackson, and I am the organizing and outreach manager for Americans for Financial Reform. Americans for Financial Reform is a nonpartisan, nonprofit coalition working to lay the foundation for a better financial system.

The hardest part in talking about this bill is figuring out where to start because it is such a comprehensive disaster. This legislation would be better dubbed the, "Wall Street CHOICE Act" because it would have a devastating effect on the capacity of regulators to protect the public interest and defend consumers from Wall Street wrongdoing and the economy from risk created by too-big-to-fail financial institutions.

Not only does this bill eliminate numerous major elements of the Dodd-Frank protections passed in the wake of the financial crisis of 2008, it would also weaken regulatory powers that long predate Dodd-Frank. If this bill passed, it would make the financial regulation system significantly weaker than it was even in the years leading up to the 2008 crisis.

The basic story that CHOICE Act proponents are telling about why this legislation is needed is a lie. Financial regulation is not hurting workers, consumers, or the economy. There is no evidence that the economy is being harmed by financial regulation. In fact, lending is growing at a healthy rate.

Over the past 3 years, real commercial bank loan growth has averaged almost 6 percent annually, which is higher than the historical average of 4 percent. It is worth noting that loans at community banks are growing even faster, with community bank loan growth exceeding that of larger banks over the last 2 years.

This is not to say that everything is great for Americans. It is not. And, in fact, one of the reasons for that is the still-echoing effect of the 2008 financial crisis.

The Center for Responsible Lending's 2015 "State of Lending" report showed two trends. First, families were already struggling to keep up before the financial crisis hit. The gap between stagnant family incomes and growing expenses was being met with rapidly increasing levels of debt. Second, the terms of the debt itself have acted as an economic weight and a trap, leaving families with less available income, pushing them further into debt traps, and causing a great deal of financial and psychological distress.

Those impacted by the 2008 crisis—low- to middle-income individuals and families, and communities of color—are still rebounding. The impact of this crisis is closer to us than we realize. Just Wednesday, my Lyft driver shared with me that he had worked for, using his words, "corporate America," and when the crisis hit, he lost his job. He took a couple of consulting contracts, a couple of part-time gigs, but, in his words, he has been in a free-fall since and things have been a mess.

People live this and are still reeling with the aftermath. They think, quite sensibly, that big banks have too much power and influence, not too little.

This legislation is crammed with deregulatory giveaways that would facilitate abuses by financial institutions, private equity and hedge funds who want to manipulate the rules to enrich their executives, mortgage lenders who want to undo the safeguards against the affordable loans that drove the financial crisis, payday/car title lenders pushing products that trap consumers in a cycle of ever-increasing debt, and far more.

The "Wall Street CHOICE Act" would strip, as already mentioned, the powers of the Consumer Financial Protection Bureau to address abusive practices in consumer markets, returning us to the regulatory patchwork that failed before the crisis as well as the reason the consumer agency was created to solve.

It would also eliminate critical elements of regulatory reform passed since the crisis, including restrictions on unaffordable mortgage lending; the Volcker Rule, as mentioned; the ban on banks engaging in hedge-fund-like speculation; and restrictions on excessive Wall Street bonuses and more.

And, lastly, it would increase the ability of too-big-to-fail financial institutions to hold up the public for a bailout by threatening economic disaster if they failed.

It just seems that what all this means has escaped members of this committee. This legislation begs the question, do its drafters

fully grasp the economic devastation unleashed by a failure to control Wall Street predation?

It would be like a Peace Corps volunteer returned home after serving abroad for 2 years, only to find out at the airport that her childhood home had fallen into foreclosure. It is a pastor who had to put a two-time limit on helping parishioners who have fallen victim to the online payday debt trap lending scheme so that he can help the next person. It is the misuse of the criminal justice system by debt collectors threatening a mother of two with jail time. It is reflected in the soulless neighborhoods full of dilapidated properties with "foreclosed" signs.

It is profoundly foolish to eliminate safeguards against the catastrophic consequences of a financial crisis. It is also wrong to place such severe restrictions on the ability of regulators to protect the public from exploitation in their everyday transactions with the financial system. We urge you to reject this radical and destructive legislation.

Thank you.

[The prepared statement of Ms. Jackson can be found on page 89 of the appendix.]

Mr. HOLLINGSWORTH. Mr. Bertsch, you are recognized for 5 minutes.

STATEMENT OF KEN BERTSCH, EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS

Mr. BERTSCH. Thank you. Thanks, members of the committee, for the opportunity to be here.

My name is Ken Bertsch. I am the executive director of the Council of Institutional Investors, a nonpartisan, nonprofit association of employee benefit plans, foundations, and endowments, with combined assets exceeding $3 trillion. We also have associate members, including asset managers, with more than $20 trillion in assets under management.

I appreciate the opportunity to appear before you today. I respectfully request that the text of my testimony, including the Council's April 24th letter to the chairman and ranking member, be entered into the public record.

Members of the Council include funds responsible for safeguarding assets used to fund the retirement benefits of millions throughout the United States. They have a significant commitment to U.S. capital markets. They are long-term, patient investors, due in part to the heavy commitment to passive or indexed investment strategies. As a result, issues relating to the U.S. financial regulatory system, particularly involving corporate governance and shareholder rights, are of great interest to our members.

In its current form, we believe that the Financial CHOICE Act, if enacted, would weaken critical shareholder rights that investors need to hold management and boards of public companies accountable and that foster trust in the integrity of the U.S. capital markets.

Americans suffered enormously from Enron and other corporate scandals of 15 years ago and even more from the failures of oversight that contributed to the 2008 financial crisis. The bill would heavily damage shareholder rights and threaten prudent safe-

guards for oversight of companies and markets, including sensible reforms made after both the Enron crisis and the financial crisis.

Let me highlight five areas of concern.

First, the bill would set prohibitively costly hurdles on shareholder proposals. The bill would require ownership of at least 1 percent of stock for 3 years, compared with the current requirement of $2,000 for 1 year, in order to, as a shareholder, submit a proposal to the ballot for all shareholders to vote on. This is a dramatic change. So you go from $2,000 to $7.5 billion at Apple to be able to do this, $3.4 billion at Exxon, and $2.6 billion at Wells Fargo.

Since the 1940s, and especially since present rules came into force in the 1970s, shareholder proposals have led to many important corporate reforms. One example: I used to work at TIAA, which is an asset manager for university and healthcare systems. We used resolutions to push for independent boards that would not be rubber stamps. Expectations for boards now are much higher than pre-Enron. And that is due in no small measure to shareholder proposals over many years.

Now, TIAA, with about $850 billion in assets under management, essentially would not be able to submit shareholder proposals anymore under this rule. It is not large enough. It typically owns 0.7 percent of a company. TIAA would be out. CalPERS owns $300 billion in assets; they would also be out of luck. Indexers would generally be out of luck, except for BlackRock, Vanguard, and State Street, who have never submitted a shareholder proposal. Some corporations are comfortable with those three among the index providers submitting shareholder proposals because they don't do it.

Second, the bill would roll back curbs on abusive pay practices. Shareholders would get an advisory vote on executive compensation only when there is an undefined material change in CEO pay. Most U.S. public companies, at the request of their shareholders, currently offer investors say-on-pay votes annually. It is not required in the Dodd-Frank Act, but there is a choice of how often, and investors have opted for annually. The say-on-pay votes have resulted in much greater shareholder engagement, much better communication between companies and shareholders, and progress on executive pay.

Third, the bill would restrict rights of shareholders to vote for directors in contested elections for board seats. The provisions of the bill would bar universal proxy cards that give investors freedom of choice to vote for exactly who they want to when there is a proxy contest rather than being forced into a party-line vote only.

Fourth, the bill would create an intrusive new regulatory scheme for proxy advisers that provide shareholders with independent research that they need in order to vote responsibly. The bill would drive up costs for investors, potentially compromise the independence of advisers, and impinge on their ability to provide honest advice to clients.

The final thing I want to focus on is that there are various elements of this bill that would shackle the Securities and Exchange Commission, including requiring excessive and unworkable cost-benefit analysis, apparently intended to tie the SEC's hands. The

provisions would severely undercut SEC authority to fulfill its mission to protect investors, police markets, and foster capital formation.

So those are the areas I want to summarize. We are glad to work with committee members on improving U.S. capital markets. And thank you for the opportunity to speak.

[The prepared statement of Mr. Bertsch can be found on page 52 of the appendix.]

Mr. HOLLINGSWORTH. Mr. Chopra, you are recognized for 5 minutes.

STATEMENT OF ROHIT CHOPRA, SENIOR FELLOW, CONSUMER FEDERATION OF AMERICA

Mr. CHOPRA. Thank you, Mr. Chairman, and members of the committee, for holding this hearing today.

My name is Rohit Chopra. I am a senior fellow at the Consumer Federation of America. I was previously Assistant Director of the Consumer Financial Protection Bureau, and I also was named by the Treasury Secretary as the consumer agency's first Student Loan Ombudsman, a new position established in the Dodd-Frank Act.

Less than a decade ago, our economy was in free-fall, with no single accountable regulator to police the mortgage market against lies and deception, especially in the nonbank sector. Toxic lending whacked Main Street and Wall Street and our whole economy down.

Now, the stories and statistics of families who lost their jobs, their savings, and even their homes are still so raw for so many, but I want to tell you about another piece. There was an aftershock of the financial crisis that we shouldn't forget about, a crisis that crushed both family budgets and State budgets.

For the millions who went off to, or were already in college, their families had fewer financial resources to support their child's education, and State universities across America had to jack up tuition due to budget cuts. This double-whammy helped lead to an explosion of student debt.

Since the collapse of Lehman Brothers, outstanding student debt has more than doubled. Today, roughly 43 million Americans collectively owe $1.4 trillion in student debt. And that doesn't even count other debt for college like home equity loans and credit cards that so many families use.

And as repeated research has shown, problems in the student loan market bear an uncanny resemblance to what we saw in the mortgage market: subprime-style lending fueled by securitization markets and slipshod servicing, leading to unnecessary defaults.

But, fortunately, there is a lot more accountability for those who break the law today, and that is because of the CFPB. But the proposed legislation would essentially destroy the consumer agency's authorities, forbidding it from engaging in regular supervision of the student loan industry and stripping it of its powers to police the market for unfair, deceptive, and abusive acts and practices.

Here are just a few of the enforcement actions that could not have occurred if the proposal were the law of the land.

Now, I know all of you know about the Wells Fargo fake account scandal that came to light in September 2016. But just 2 months earlier, the CFPB also fined Wells Fargo millions for illegal student loan practices, including allocating borrower payments strategically in order to maximize late fees. This would not be possible under the proposal today.

In 2015, the CFPB announced that it had caught Discover, another big student lender, for illegal billing and debt collection practices. This would not be possible under the proposal today.

In 2014, the CFPB sued Corinthian Colleges—this is a company that was very aggressive in many of the districts that you serve—for an illegal student loan scheme coupled with strong-arm debt-collection tactics to shake down their students. Ultimately, the CFPB secured $480 million in debt relief for borrowers, and Corinthian is no longer operating. This action would not be possible if the proposal were made the law of the land.

And just this year, the CFPB sued student loan behemoth Navient, formerly known as Sallie Mae, for illegally cheating borrowers out of their repayment rights through shortcuts and deception at every stage of the repayment process so that it could pad its own profits. The allegations are so severe, impacting millions of borrowers. This action would simply not have been possible under the proposal since the agency would lack the authority to enforce all of the critical consumer protection laws.

We all know that our student loan system is badly broken. It is not working for borrowers, for taxpayers, or for the honest student loan companies who are forced to compete with bad actors.

The way I see it, Congress has a choice. It can choose to have amnesia and forget about the millions of Americans who lost their homes and jobs due to a financial system fraught with fraud and loaded up with risk; it can choose to turn its back on the millions of student loan borrowers who are just trying to pay their loans off. Or it can stand with honest businesses, it can stand with consumers, and it can stand with everybody who plays by the rules. And we will all be watching closely to make sure you don't make the wrong choice.

Thank you.

Mr. HOLLINGSWORTH. Ms. Edelman, you are recognized for 5 minutes.

STATEMENT OF SARAH EDELMAN, DIRECTOR, HOUSING POLICY, CENTER FOR AMERICAN PROGRESS

Ms. EDELMAN. Thank you.

Good morning, Mr. Chairman, Ranking Member Waters, and members of the committee. Thanks for holding the hearing today, and thank you for being here with us. My name is Sarah Edelman, and I direct the housing policy program at the Center for American Progress.

The proposals laid out in the wrong choice act 2.0 threaten the stability of the Nation's housing market, economy, and financial system. The legislation would deregulate Wall Street and put the United States in the same perilous position it was right before the 2007–2008 crisis. Yet it is often described by its supporters as legislation designed to help small community banks. If the intention

is to strengthen community banks, then we are talking about the wrong bill.

Let's start with a review of the facts about community banks. First, as Senator Warren said earlier, by many measures, community banks and credit unions in the United States are the strongest they have been in decades. Community bank profits are up to where they were before the crisis. Consumer lending at small banks exceeds pre-crisis levels. Mortgage lending has increased by nearly 40 percent between 2012 and 2015, according to a recent analysis by the Center for Responsible Lending. Credit unions added 4.7 million new members last year, the largest annual increase in credit union history, according to their trade association.

However, it is true that community banks face more financial and administrative hurdles than larger banks that can spread operation costs across many bank branches. And since the 1980s, the number of community banks in the United States has declined every year.

Most community banks are small businesses working to compete against larger ones in an ever-changing market. And that is why Congress and regulators have already developed a tiered regulatory system, where community banks are carved out from many of the requirements big banks need to meet. For instance, community banks are generally not subject to many of the Dodd-Frank provisions, including stress testing, the requirement to create a living will, or CFPB enforcement. Community banks are also given greater flexibility with their mortgage underwriting standards.

The wrong choice act takes many of the carve-outs that are currently reserved for community banks and gives them to the big banks that crashed our economy a decade ago for a very small price. The bill also scraps many of the regulations Congress applied to nonbank financial institutions, often major competitors of community banks.

So, while supporters of the bill talk about how it will help Main Street, it seems best designed to ease standards for Wall Street.

The proposal would also rattle the foundation of the housing market. About a decade ago, some of the very organizations on this panel pleaded with you to stop the predatory lending that was stripping their communities of wealth. Nearly 10 million foreclosures later, it is disheartening that many of our organizations are back here again, this time trying to keep some Members of Congress from reopening the doors to practices that drained wealth from hardworking Americans.

In the aftermath of the crisis, Congress put commonsense standards in place to protect consumers and the housing market from predatory mortgage loans. These standards included a commonsense rule that a lender must evaluate a borrower's ability to repay a loan before they originate it. It included more accountability for lenders who make bad loans and incentives for originating loans with affordable loans.

Title 5 of the wrong choice act undermines many of these core mortgage protections and turns the clock back to a dangerous time in our housing market. Buyers of manufactured housing, in particular, who are already ripped off on a regular basis by mobile home companies, are made especially vulnerable by the proposal.

The men and women in your district may not know what the qualified mortgage or ability-to-repay rules are, but they will notice if their neighbors and family members begin getting bad loans again or when there is another housing or financial crisis. And they know a giveaway to Wall Street when they see it. Please stand up for families and oppose this bill.

Thank you.

Mr. HOLLINGSWORTH. Votes have been called. The committee will return immediately after the vote. The committee stands in recess.

[recess]

Mr. HOLLINGSWORTH. The committee will come to order.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. Mr. Chairman, thank you for recognizing me, and also thank you to the ranking member.

Let me just ask the panel this question. I have consumer justice meetings in my district all the time. I also meet with the Financial Services Committee. I try to talk to everybody. But in my consumer advocates meeting, I said, well, there is this CHOICE Act coming up, and one of the things it does is it undermines the Consumer Complaint Database.

And I want to ask you, how does the Consumer Complaint Database actually help consumers access even the private bar, to do some self-help, in terms of bringing forth real accountability for what might be abuses in the industry?

Ms. Liner, it looks like you kind of feel my drift here. Would you like to respond?

Ms. LINER. Thank you, Congressman. I am an active listener.

Mr. ELLISON. Great.

Ms. LINER. So one thing I would like to point out is that a corollary to the CFPB is the Consumer Product Safety Commission. It has a similar mission but in a different sphere, and they also have a public database where consumers can submit concerns about products that are on the market, such as cribs and toys. So it seems appropriate that there is also a public database for concerns about financial products.

Mr. ELLISON. Right. So the CFPB does in fact have such a database, and people have used it.

Do you guys have any information to share on the importance of that particular tool? Because the advocates in my district felt like it was pretty important. Anybody here want to weigh in on that?

Mr. CHOPRA. Congressman, I think it was a complete game changer. When I was at the Bureau and the database came online, all of a sudden the rhythm with financial institutions and their consumers changed.

Mr. ELLISON. Right.

Mr. CHOPRA. They knew that those complaints were going to be out in the public and they were going to be used.

I will tell you one story. We collected a lot of complaints and did some deep analysis of it, and we found a trend of servicemembers and their families being overcharged on their student loans. We actually then referred those complaints to the Department of Justice. And guess what? It wasn't just a handful, it was 78,000 of them, who ended up getting $60 million in refunds. And now companies

are looking at their complaints and seeing that they have to treat customers fairly or they may face some real consequences.

Mr. ELLISON. Even if one of those consequences was just the light of day.

So, Professor Coffee, I would like for you to weigh in on this issue. I have this theory, and I would like you to offer your candid comments on it, which is that good consumer protection actually helps business. Why? Because so much of business relies upon confidence. And so, if you have a situation where people are bilked and taken advantage of, it kind of creates this incentive, where ethical businesspeople are kind of dragged into that just to stay competitive.

Do you have any comment on that you would like to share?

Or, Ms. Edelman, maybe you have a viewpoint on that issue?

Ms. EDELMAN. Sure. I think you are exactly right, Congressman. One of the issues we saw in the run-up to the housing crisis was even some of the more honest lenders having trouble competing with the folks who were doing really shady things, because these shadier practices produced more returns and higher profits in the short term.

And so it drags even the good guys into it, which is why it is so important to make sure that there is a solid floor of regulations.

Mr. ELLISON. Mr. Coffee, do you want to comment on that?

Mr. COFFEE. I am going to leave that to the people who are really the experts on—

Mr. ELLISON. Okay. Mr. Chopra?

Mr. CHOPRA. Yes. So, in addition to what I said before, I think it is pretty unfair for somebody who treats their customers fairly, plays by the rules, and then they get dinged by their investors for not hitting the same return on equity as their competitors.

Mr. ELLISON. Right.

Mr. CHOPRA. And you know what? The ones who end up following the rules have much more sustainable profitability, which is probably better for our whole economy. There is increasing research to this point. And we should really be not just protecting consumers but protecting the companies that are playing by the rules in the first place.

Mr. ELLISON. Well, absolutely. And my friends on the other side of the aisle tend to make this case, "We are for business." They are not for business; they are for short-term abusers of the process. And we are for long-term sustainability of the economy.

I think I am pretty much out of time, so I yield back.

Mr. HOLLINGSWORTH. The gentleman yields back.

The Chair now recognizes the ranking member of our Capital Markets Subcommittee, the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you. Thank you so much. I would like to thank the chairman and especially the ranking member and all my colleagues for calling for this important hearing. I can tell you, it makes a real difference to have a whole panel of Democratic witnesses on this important bill.

My question is for Professor Coffee from the great University of Columbia, located in the City of New York.

And I would like to ask you about the chairman's latest version of the immoral wrong choice act, which would make it much harder for shareholders to make their voices heard by making it harder for them to submit a proposal at a company's annual meeting.

The Comptroller of the City of New York has been very active on this. I would like to place, with unanimous consent, his comments, his letter into the record.

Mr. HOLLINGSWORTH. Without objection, it is so ordered.

Mrs. MALONEY. Thank you.

Specifically, the bill would say that only shareholders who own at least 1 percent of the company's shares—could be hundreds of millions of dollars—for at least 3 years can offer proposals to be voted on at a company's annual meeting. And this is just plain wrong.

This serious requirement ignores the value that shareholder proposals have had on companies. For example, shareholder proposals were the reason why independent directors constitute a majority on the board, which is now standard practice, and that the audit and compensation committees are independent.

So, Professor Coffee, given these successes and the important role that shareholders play in corporate governance, my question is: Does it make sense to impede the ability of shareholders to make their voices heard through this proposal?

And I would like to also add to the record the statement from the Irish National Caucus from Father McManus. And, in this statement, he brings it down to the reality of what it means. He says, with these proposed changes, to submit a shareholder proposal to Wells Fargo or anyone else, one would have to own $2.5 million in shares, where at present one only needs to own $2,000 worth of shares for 1 year. So this is a huge change.

Mr. HOLLINGSWORTH. Without objection, it is so ordered.

Mrs. MALONEY. And I would just add, to the great Professor Coffee, aren't shareholders the ultimate owners of the companies that invest the funds necessary for companies to raise capital and to grow? And so wouldn't harming their rights actually harm the companies and actually harm the overall economy of the United States of America?

Mr. COFFEE. It is very easy to answer your question. Thank you for an easy question, because I think the answer is yes.

As you point out, 1 percent of Apple is something like $7.5 billion. Moreover, there is also real bite in the 3-year rule, because it disqualifies a whole class of investors, the hedge funds and other short-term holders. They hold nothing for 3 years.

If you look at the large pension funds, they are generally indexed, and very few indexed pension funds could own 1 percent of a giant company like Apple. So you get down to maybe no more than a dozen or so shareholders that would be in a position to have that 1 percent and that would have any interest in sponsoring a shareholder resolution because they represent either pension or mutual funds or other broad-based people. So it is a disenfranchisement of shareholders.

Also, as you mentioned in the first part of your question, the SEC has moved toward the idea of a single ballot on which all the names of all the contestants for election to the board would be list-

ed. That simplifies the voting process. But this bill would expressly reverse the single-ballot proposal. And, again, that would require you to deal with competing yellow and blue and green proxy cards, making the process somewhat more difficult.

So I don't think this is the most important thing in this bill, but I think, in terms of corporate governance, it does restrict shareholder access.

Mrs. MALONEY. And, also, Professor Coffee, I would like to ask you about the leverage ratio. Under the chairman's bill, any bank that meets a 10-percent leverage ratio would be exempted from all other capital and liquidity requirements, including the risk-weighted capital requirement that has been at the center of U.S. banking regulation and international banking regulation for decades.

So, essentially, the leverage ratio would become the primary capital requirement, and, as a result, many banking regulators have commented and contacted us and have argued that relying solely on the leverage ratio would give banks an incentive to get rid of their safest assets, like U.S. Treasuries, and load up with riskier assets.

Do you agree?

Mr. COFFEE. I think you have now touched on the most important provision in this bill, which is the off ramp. And the off ramp works off a single metric, a leverage ratio of 10 percent.

Now, I could understand the off ramp if it was limited to smaller banks. We can argue about what smaller banks were—$1 billion, $10 billion, $50 billion—but for smaller banks, there might be a case for this. This would apply to our largest banks, and you can escape everything in Dodd-Frank if you can get the requisite 10-percent leverage.

We have seen what will happen. We saw this with Lehman back in 2008. They wanted to show an attractive leverage ratio, and they gamed the system.

Mr. HOLLINGSWORTH. The gentlelady's time has expired.

Mr. COFFEE. One sentence: Every quarter, they engaged in one transaction that for one day only gave them the requisite leverage.

Mr. HOLLINGSWORTH. The gentlelady's time has expired.

Mrs. MALONEY. Thank you, Professor, for your life's work. Thank you.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. I will pick up on what the last witness was saying, and that is, credit default swaps would allow a giant bank to have, yes, 10-percent capital against their liabilities, but credit default swaps create perhaps a trillion dollars of contingent liabilities. They are not on the balance sheet. They don't affect your ratio. You are out of Dodd-Frank. A bank with a million dollars of assets and $100,000 of capital would be legally allowed to do a trillion dollars' worth of credit default swaps.

I have been to over 1,000 hearings in this room organized by Republicans selecting the bulk of the witnesses, and so I thought I would rant a bit about the Republicans not being here, not listening, not gaining insight. And then I realized what is really happening. They are all back in their offices, glued to their television

sets. They know they can learn more if they don't interrupt with their own questions.

And knowing that my friend, Chairman Jeb, is watching, let me implore him: Please split up this bill. This bill includes a dozen individual bills that a majority of Democrats and a majority of Republicans voted for. Those bills could become law.

This bill can never become law unless the Senate goes thermonuclear, and it is not going to do that. You need eight Democratic votes to pass anything. You are not going to get a single Democratic vote in this committee or on the Floor. How are you going to get eight Democrats in the Senate?

So this is a messaging bill. And what is the message? The message is: Democrats are voting against every change that could possibly be made in Dodd-Frank. The Democrats are treating Dodd-Frank as if it is a canonized scripture.

The fact is, I was a cosponsor of Dodd-Frank. It is not a perfect bill. I have never voted for a perfect bill. And when that bill was written, it was written here in 2128; it didn't come from Mount Sinai. We can improve it.

Now, I had a prior visual up on the board showing the enormous trade deficit.

And, Ms. Klemmer, we haven't had the great economic growth in the last few years that we would like to see. Is that because of Dodd-Frank, or is that because we have trade policies where we have a $600 billion trade deficit with the world every year, leading to well over $10 trillion of what we owe the rest of the world? Now it is up to $11 trillion, excuse me. It is going fast.

Which is the cause of the slow economic growth, Dodd-Frank or trade policies that lead to the world's largest trade deficit?

Ms. KLEMMER. I think a lot of the other witnesses have provided statistics that Dodd-Frank has not slowed lending or had any negative impact on the economy. In fact—

Mr. SHERMAN. What about our trade policies? Any negative impact?

Ms. KLEMMER. I am getting to the trade policies, certainly. The trade policies absolutely have caused tremendous problems for U.S. manufacturing and all of our industries, and it is been a series of corporate-authored bills that have undermined American workers across-the-board. And I—

Mr. SHERMAN. Thank you.

I want to go on to the next visual, because there is this argument that the Obama years have been bad years. The fact is that during his Presidency, which is somewhat coincident with the application of Dodd-Frank, we have seen the stock market go up by 180 percent, corporate profits by 112 percent, auto sales by 85 percent, consumer sentiments up 60 percent. The number of jobs in the country is up 8 percent, and you can see that insert showing how the unemployment rate dropped from the beginning of his Presidency to the end, down to 4.6 percent. The number of uninsured Americans dropped 39 percent. The Federal deficit dropped 58 percent.

In contrast, during the first quarter of the Trump Administration, we have seen the most anemic economic growth that we have had for many years. And he just came up with a proposal to take

that Federal deficit, which has gone down by 58 percent over the Obama Administration, and have it explode into many trillions of dollars over what would I guess be his first 4 years in office.

So this idea that Dodd-Frank and Obama are coincident with bad economic performance and that the last 3 months have been spectacular economic growth is very convincing unless you look at the numbers.

Finally, I couldn't let this go without saying the cause of the problem was the bond rating agencies. They gave AAA to Alt-A. Portfolio managers had to buy them in order to maintain a competitive rate of return on their investment. And as long as the umpire is selected by one of the teams, namely the issuer, we are just cruising for the next crisis.

I yield back.

Mr. HOLLINGSWORTH. The gentleman yields back.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Liner, during the crisis, when we were concerned that our banking system could collapse, many large banks paid out billions in dividends to enrich their shareholders. Dodd-Frank ended this practice by preventing banks from paying dividends if they fail their stress test. But in the wrong choice act, there is no penalty for failing stress tests if the banks qualify over the low bar that lets them get out of their safety regulations.

Do you share my concern that the wrong choice act will reverse this important safeguard?

Ms. LINER. Thank you very much for your question, Congresswoman. I do share your concern, and thank you for bringing up this point.

One of the biggest scandals that occurred during the financial crisis is that banks were still paying dividends, billions in dividends, at the same time that they were begging the Fed for help to keep their doors open.

In fact, in the fourth quarter of 2008, banks gave out over $6 billion in dividends to their shareholders. At the same time during the fourth quarter of 2008, nearly 5 million Americans lost their jobs because of the onset of the financial crisis.

So thank you for bringing this up, because stress tests are a test, and tests have consequences.

Ms. VELAZQUEZ. Thank you.

Mr. Bertsch, clearinghouses play a critical role in managing risk and promoting stability in our financial markets. Because of this, some clearinghouses that have been deemed systemically important have been subjected to enhanced supervision pursuant to Title VIII of Dodd-Frank.

Are you concerned that doing away with this enhanced supervision and some of the related tools given to the supervisors will introduce risks to the financial markets and the small businesses and consumers who rely on them?

Mr. BERTSCH. Yes, I am concerned, although that has not been the primary focus of our attention at this point on this week-old bill. But, yes, we are concerned—I am concerned about the over-

sight structures, not only the SEC but the clearinghouses and otherwise, that in various ways this bill undercuts.

Ms. VELAZQUEZ. Thank you.

Ms. Liner, under the wrong choice act, if a bank maintains a 10-percent quarterly leverage ratio, it can choose to opt out of Dodd-Frank's enhanced prudential standards, including risk-based capital rules, liquidity requirements, risk management standards, resolution plans, stress testing, and other important safeguards.

Can you explain why more than a simple leverage ratio is required to ensure a global megabank operates in a safe and sound manner?

Ms. LINER. Yes. Thank you, Congresswoman. You just provided a really important list of the various tools that Dodd-Frank uses to ensure that our financial sector is safe, stable, and healthy.

To explain what some of these are: Liquidity requirements. This is different from a leverage ratio and capital requirements because it makes sure that banks not just have enough assets but enough liquid assets. Because assets like loans and securities are not as liquid as cash. And the cause of some of the large bank failures during the crisis is that they did not have access to enough liquid assets; they couldn't liquidate many of their assets in time to be able to stay open.

Risk management standards, another excellent example of a Dodd-Frank reform that keeps consumers and investors safer. It is incredible to think that a publicly traded bank holding company did not have to have a risk management committee or a risk management officer prior to Dodd-Frank.

And, finally, I would just like to add the countercyclical buffer. So the leverage ratio is always 10 percent, whether we are in an economic expansion or an economic recession. And in Dodd-Frank, there is a countercyclical buffer that requires banks to take on more capital if economic conditions deteriorate.

Ms. VELAZQUEZ. Thank you.

Ms. LINER. Thank you.

Ms. VELAZQUEZ. Mr. Coffee, would you like to comment? You have 25 seconds.

Mr. COFFEE. I agree with what she said. As long as you use a single leverage point, you are inviting banks to greatly increase the risk level of their assets. They will trade in those stodgy, old, dull treasuries and buy very risky credit default swaps. And that is dangerous, but they could do it under a single metric test.

Ms. VELAZQUEZ. Thank you.

Mr. HOLLINGSWORTH. The gentlelady yields back.

The Chair now recognizes the ranking member, the gentlelady from California, Ms. Waters.

Ms. WATERS. Thank you very much.

I would like to first thank all of our presenters here today. It is so important for you to be here to help educate the public about this wrong choice act and the devastation that it would cause should it pass.

I would like to say to Reverend Willie Gable, Pastor at the National Baptist Convention USA, I want to thank you for what you are doing. You talked about these minority communities, African American communities being targeted.

Rev. GABLE. Yes.

Ms. WATERS. And we find that all of the schemes, all of the rip-offs that anybody can think of, they target them right into the most vulnerable communities. And I know it creates a lot of work for those of you who are trying to look out for the least of these.

You talked about the woman who was taken advantage of with dementia. Could you just share with us the kind of harm that you have experienced from those who have been taken advantage of? Maybe they are similar to the woman with dementia or in other ways. Do they have to come to the church and then ask them for money once they are burdened with this debt and they can't pay it and they can't get any more money? What do you guys have to do to help them?

Rev. GABLE. Thank you, Congresswoman.

First of all, let me say that there seems to be a philosophy that has occurred in this country that engenders this idea that the poor should pay more for everything—more for a car, more for a home, more for food, more for access to capital. I don't know where it came from. And these are working poor. We are not talking about people sitting on the street.

What happens is that the faith institutions end up having to support this. Our Faith for Just Lending Coalition, which is a coalition of the Catholic bishops, the National Evangelical Association, Southern Baptists, National Baptists, PICO, working together, all of us, to a group, an institution, are finding the same thing, that we are supporting, that every day we have individuals, every week, coming in who are having massive problems because of predatory lending—particularly predatory lending.

And it is a designed, it is a planned effort that these lobbyists have worked and they continue to work. Even while this bill, this Wrong Choice bill, is being discussed, they are planning on how they can come up with ways to get into this community.

We have individuals every week who come to us and, through our benevolent fund, we have to give support to them because they can't get out of debt.

Ms. WATERS. Well, Reverend, I would like you to help us get the word out about this Wrong Choice bill. It would take away the authority of the Consumer Financial Protection Bureau to develop rules about how they operate. So when you go back to the convention and you talk with the other pastors and all those who you are aligned with, let them know we have to stop this Wrong Choice bill.

Rev. GABLE. We shall do that.

Ms. WATERS. Thank you.

Let me just add one other thing. There was a lot of discussion, I think, from—who is that over there?—yes, about community banks. And people don't know, for the most part, that we have exempted them from some of the rules of the big banks. They come in here and the big banks hide behind the community banks and would have you think that—they are talking about regulations that—causing the little banks problems, but really it is the big banks.

Would you expound on that just a little bit more?

Ms. EDELMAN. Sure. I would be happy to.

That is exactly right. We have been very concerned that Congress would roll back financial reform in the name of helping the little guy, when the wrong choice act is really about giveaways for the big banks.

Small community banks have exemptions from a number of Dodd-Frank provisions. Only 2 of the roughly 6,000 community banks—or 4, I am sorry, 4 of the roughly 6,000 community banks do stress testing. They don't have to do living wills. They have more underwriting flexibility. The CFPB has worked with them time and time again to make sure that the regulations are properly tailored for them. Small businesses, including many community banks, get an opportunity to submit early comments. The CFPB and other regulators have all created new advisory councils, including with the community banks.

So community banks are already carved out of many of the provisions that were designed for the bigger banks. And expanding these exemptions for the big banks isn't going to do much to help the little guy.

Ms. WATERS. Thank you so very much.

And I yield back the balance.

Mr. HOLLINGSWORTH. The gentlelady yields back the balance of her time.

The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you.

And thank all of you for your testimony that you have been giving thus far, because it is very important. We have found that many of my colleagues on the Republican side of the aisle have amnesia about what took place before 2008 and the people that it has affected. And you clearly have in your testimonies reminded all of America, thereby helping us to let our constituents know how important it is that we stop the wrong choice bill because it is not helpful to them.

With that, let me ask Ms. Liner, in 2007 and 2008 we saw banks were still paying dividends to their shareholders even though they were experiencing a lot of losses. An example of this was Lehman Brothers, which eventually received taxpayer money, continued to pay dividends until after their bankruptcy.

Dodd-Frank allows regulators to prevent such dividends if banks do poorly on their stress test. Could you explain for my constituents so that they understand why stress testing is important and how the wrong choice act's proposals to prevent regulators from limiting dividends will water down stress testing?

Ms. LINER. Of course. Thank you, Congressman.

Stress testing is a critical, proactive tool that we can use to ensure that our banks are strong enough for a future recession.

And one thing that we saw happen in the financial crisis is that banks that weren't strong enough to stay open without extraordinary help were still paying out dividends to their shareholders and making capital distributions.

Under the wrong choice act, there would be no penalty if a bank repeatedly failed a stress test to prevent them from paying out dividends. We saw that this behavior is simply unacceptable during

the financial crisis, and Dodd-Frank does the right thing by making stress tests matter.

Thank you.

Mr. MEEKS. Thank you. Thank you very much.

And then there is one other issue that has been important to me. Some of you may know that I also serve on the House Foreign Affairs Committee. And I know that we have been working very hard and negotiating, for example, with the EU to ensure that our financial regulatory systems can work in harmony. We are so interconnected.

So, Ms. Liner, again, many of the institutions we regulate are also regulated abroad, right? And there are aspects of Dodd-Frank that would disrupt our cooperation with these agreements abroad.

So, if you could answer this question, what kind of impact can the lack of financial cohesion between the United States and the EU have on the everyday American who we are focused on? A lot of times, people don't recognize what the global aspects of something are, how it affects us locally. Can you briefly explain what effects it would have on the local constituent?

Ms. LINER. Sure.

The United States is a leader in global financial regulation, and for a good reason: Because we are a leader in the financial sector. There are a variety of global agreements that the United States has led and is a party to that ensure that all banks globally are prepared for anything that may arise in the global economy.

Some of the things that the United States is a part of, with global systemically important banks—we have eight banks that meet this criteria, and they are required to carry higher levels of capital. They are required to participate in the liquidity coverage ratio at a higher standard than other banks. And there are few other regulations by Basel III, the total loss-absorbing capital and net stable funding ratio rules, that it would be a concern if we no longer participated in them for our standing in the global economy.

Mr. MEEKS. Thank you very much.

And in my last few seconds, let me just say that I know that before the crisis of 2007 there was no one anywhere who spoke for the consumers. And that is the reason why the Consumer Financial Protection Bureau was created.

And I know, Reverend, that it is difficult for many of your parishioners who folks are trying to bring these products up to, and they are not individuals who are reading the fine print, nor do they have anyone to advise them of where to go.

So, with the Consumer Financial Protection Bureau, I would hope that—and maybe you can tell me that you have been—that you can refer or give individuals a name or a number to call within the Consumer Financial Protection Bureau so that they can say, "Check out this proposal," so that they could have confidence that they are doing the right thing and someone is not trying to pull a con game or trying to do something that is not good for them.

That is good for you, isn't it?

Rev. GABLE. Absolutely. The CFPB has been just a yeoman's group for protecting the most vulnerable. And it is unfathomable to me that this Wrong Choice bill would try to eliminate some of the great things. It brought back $11 billion, that's "billion, with

a B." They have returned that amount of money to consumers and to other agencies. Why would you try to eliminate something like that?

The proposed rule for payday lending that is coming about and the work that we have been doing, it is something—and I hear the tick, tick, tick. But the problem is so immense and the passion we have—I understand, Mr. Chairman. But this is something we have to fight for.

Mr. HOLLINGSWORTH. The gentleman's time has expired. The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. And I want to thank the panelists.

There are so many bad things in this bill that the truth is there is part of me that doesn't even think we should bother talking about it, because there is no way this bill can be fixed enough to make it worth discussing. But here we are, and we are going to have to vote on it, I think next week? Next week. So I want to be really clear, for those of you who have activist communities, you best get them going, because the time is now and they need to know about it.

But I want to focus on a couple of things. First of all, I want to follow up on what the ranking member was talking about. I am a community bank guy. All my money that I have, my personal money, my campaign money, my wife's money, it is all in community banks, a couple of credit unions, in community banks, because I am the guy who likes to know the person behind the glass and they want to know me. So when I say that, I have nothing against big banks, I think we need big banks to have an effective economy. Big business does, but I don't.

All that being said, every time a community bank has come in to see me, they know I am their friend, and I tell them all the same thing, basically what the ranking member was saying: You do realize they are using you, they are hiding behind you.

And I guess, for the sake of discussion, I would like to ask the panel, does anybody here object if, for the sake of discussion, again, I know we would have to come up with an actual number, but if I said for the sake of discussion any bank below $25 billion is exempt from every Dodd-Frank provision, and as far as I am concerned, exempt from the QM provisions if they hold a mortgage on their own books, anybody here, will your head explode if you hear something like that? Am I completely off?

Ms. EDELMAN. Twenty-five billion sounds pretty high. The FDIC defines community banks as below $10 billion. So if you move that to $2 billion or $10 billion, I would get more comfortable there.

Mr. CAPUANO. But everybody has a different definition. They have a definition. That $10 billion definition has been around for a long time and not adjusted for inflation.

I think that is what I would like to do. Again, I am not sure of the number. I am happy to discuss the number. But that way we get the people that we never wanted to get off, they can go home, continue doing their banking, servicing the communities, and we can talk about the people that, I don't think they are actively try-

ing to ruin the economy, but they did it, and they might do it again.

I also want to focus for a minute on items that I think the average person might have an understanding of. And, again, most people don't understand capital ratios and living wills and all that kind of stuff. But I think there is at least one thing they understand, there are a couple, but I think there is one in particular, and that is shareholder activism.

We have a provision in Dodd-Frank that says if you own the lesser of $2,000 worth of shares or 1 percent, whatever the lower amount is, you have a right to offer a proposal to the corporation that they have to accept. You may not win, but you have that right.

This provision says—they changed that to a minimum of 1 percent of the corporation and you have to hold it for 3 years. That takes everybody I know out of this and many sizeable investors, not just my mother. It takes out a lot of sizeable investors. I don't know many people who can invest, oh, let's say a million bucks. There are some, God bless them, but I don't know them. And even at that investment, you would have a hard time making that 1 percent threshold.

The average S&P 500, the market capitalization is about $45 billion of those companies, which means you would have to have $453 million invested in that company for 3 years before you could have a voice. And I have always thought that shareholders were the people who actually owned corporations. Did I make that mistake? Are they owned by the CEO or are they owned by stockholders? Did the law change?

Does anybody think that that provision is a good choice?

Ms. KLEMMER. If I could respond, there is an SEC study that actually showed a correlation between improved firm value and shareholder activism, and I think it was at least by 60 basis points, which resulted in billions of dollars of added shareholder value through their activism.

And also, typically when shares come with less rights, people expect—investors expect a higher return. And so if you start taking away rights, you could actually drive up the cost of capital for a firm. And so I think everyone loses with this. I don't see an upside.

Mr. CAPUANO. I just get shocked, because I was always under the impression that the Republican tenets were all about, it is mine, you can't use it if it is mine. And here is a situation where it is mine, I own the stock, or I own the stock on behalf of a thousand other people, and I don't have a voice in the company. Just stunning to me.

And I see my time has expired. But thank you very much for being here and lifting your voices in the right directions.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore, who is also the ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Thank you, Mr. Chairman. And thank you, Ranking Member Waters, for this hearing. And I want to add my voice to those who have thanked this very distinguished panel for very important testimony.

Let me dive right in. My time is limited. And I don't know who would best answer this question. Ms. Klemmer, Ms. Liner, Mr.

Bertsch, anybody else who feels that they are better to answer it, please jump in. But I was stunned with this legislation to see that it included a provision to repeal the fiduciary rule, which has jurisdiction under the Labor Committee, and I have worked very diligently on this best standard.

I am wondering if any of you could just weigh in for a brief moment—oh, you want to, okay—and tell us what we expect.

Ms. LUBIN. Thank you. For years, and you heard I have been a securities regulator for 30 years, we have been trying to hold the brokerage community to the standards that they advertise to their clients, that when they say they are investing their money, they are going to have money for their kids, for their college education, for their weddings, for their retirement, that those brokers act in the client's best interest.

Now, ideally in every context they would have a fiduciary obligation to their clients. For now, what the Department of Labor has done is take a big step towards getting us there and saying when a broker-dealer and their stockbrokers deal with a client and handle their retirement funds, they have a fiduciary obligation, they need to act in the client's best interest, they need to put their interest ahead, they can't just have a—this is a suitability standard.

And what this bill would do is take away the ability for the Department of Labor to adopt that rule until the SEC moves. And, unfortunately, the SEC has had the opportunity to move in this space for a long time and hasn't had the ability to do so.

So in the school of, half a loaf is better than none, I think we could get started and make significant progress by allowing the Department of Labor rule to go forward.

Ms. MOORE. Thank you so much for that.

Now, my colleague, Mrs. Maloney, asked about the 10 percent simple leverage, no risk weighting, but I also would like the panel to respond to things that have been included. Like at first, the first draft of this bill had the CAMELS rating by the FDIC included, and they took that out.

Also, I guess many of you are familiar with—also, I want to ask you about the off-balance-sheet vehicles that would be allowed—would be restored under this bill. What impact do you think that would have, briefly? Whomever it was who talked about—and this is a big panel—solvency versus liquidity. That is you, Ms. Liner?

Mr. COFFEE. I certainly have talked about liquidity, and I think that is not a complete answer simply to focus on a leverage test. But the point that I think I was making earlier today and I think maybe you are getting near is that the only way you are ever going to be able to reorganize a financial institution or a bank in any kind of liquidation or bankruptcy is by providing some access to short-term liquidity.

We do that today under orderly liquidation authority by turning to the FDIC's fund, which the industry has to replenish. We would have nothing similar, nothing else that would work in the short term if we simply moved to a Bankruptcy Act provision.

Ms. MOORE. But I specifically wanted to talk about the absence of the CAMELS ratings that are supervised by the FDIC. No one wants to respond to that? That is fine.

My time is limited. So I think Reverend Gable and some of the others of you, I know that this is an expert panel, but we did—we have had other expert panels appear before us on this topic.

One in particular is a Mr. Wallison, who is a senior fellow with the American Enterprise Institute, and he says that this crisis was not caused by credit default swaps, not poor underwriting, not inflated appraisals, not credit rating agencies, but because of maybe CRA, Freddie and Fannie, and predatory borrowers.

So, I guess, Reverend Gable, I would like to hear a little bit your view of these predatory borrowers that really caused this crisis. And I just want to remind you, he is an expert.

Rev. GABLE. I have had the privilege to speak before that group before, after Hurricane Katrina, so I could imagine something like that coming from them.

There is no such thing as a predatory borrower. It does not exist. These are individuals who are paying 400, 500, 600 percent for a loan. How can they be predatory? They are being preyed upon. And so for someone to even have the concept as an expert, I don't know what their expertise is in, but it is not in being in debt. And having to live in poverty and pay 400 percent interest, or 700 percent interest is just ridiculous.

Ms. MOORE. My time has expired. Thank you, Mr. Chairman, for your indulgence.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman, and Ranking Member Waters.

And thank you so much to this distinguished panel who is here today, and, of course, to our very own Senator Warren, who started the presentations with her testimony this morning.

Certainly, as you know, this bill that is before us today, named the Financial Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs, or the CHOICE Act, I believe is certainly a misnomer, because it is, in fact, the wrong choice for investors, for consumers, for entrepreneurs, and for the American economy. I know that firsthand because prior to coming to Congress, I fell into that category as an investor, as an entrepreneur.

And certainly it lacks hope and opportunity for the American people. But it is the wrong choice because it brings us back to the days that led us to Financial CHOICE. It is the wrong choice because it takes us back to a time when we were less investor protected. It is the wrong choice because it takes us back to a time when consumers could be taken advantage of without representation. I believe it is the wrong choice because it takes us back to a time that led the United States economy to the brink of collapse.

All of that is at stake today. And I ask you to look at the left of this chamber.

And I am going to say this today, Mr. Chairman, because I know this is your first year and you probably drew the short straw to sit in that chair.

Mr. HOLLINGSWORTH. I consider it an honor.

Mrs. BEATTY. But with that, I am going to say thank you to you for taking it, whether it was an honor or not. But, Mr. Chairman, let me just say to you, being on this committee since I was a fresh-

man, I have heard repeatedly from the Chair who traditionally sits in that seat that he would hope that we would work in a bipartisan fashion, that he would hope Democrats would participate more and come up with ideas to share, and that he welcomed that we invite people in to express their ideas and positions.

So, Mr. Chairman, I want you to know that our ranking member has spent tireless hours looking into this bill, inviting experts, and asking us to be here today to share with our colleagues.

Again, I ask everyone to look to this side of the aisle, and they are absent. So I want you to know, in meetings to come later, you are going to see a photo of that, as they always put those charts up there because they believe that the visual tells the story of our economy. Well, I think what tells a better story than any numbers, any facts that you can put up there is that we have 30-some empty seats over here when we are dealing with one of the most critical things that we could do to take a look at how we could provide choice for those individuals in all of our communities and our districts.

Now, with that said, I do have a question. I am from the seventh-largest State, the great State of Ohio. And I have heard from members of the Ohio pension system, a system that I also belong to.

So I am going to look to you, Mr. Bertsch, because I believe that is your area of expertise. And since I have had several of the pension funds that invest in our retirement of thousands of Ohioans express their concerns, can you tell me, since you represent the interest of the pension funds, like OPERS and Ohio Police and Fire Pension Fund, the School Employees Retirement System in Ohio, and State teachers, can you explain how some of the provisions of this bill hurt the ability of pension funds to effectively invest and manage the retirement of thousands of Ohioans?

Mr. BERTSCH. What we have been focused on in particular is their rights as shareholders, since they invest the bulk of their money in publicly traded companies, are severely cut back by this bill, and that is what we are most concerned about. Those rights that they have used historically to push for sustainable long-term value creation would be badly damaged by provisions of this bill. That is really the core thing I would want to address.

Mrs. BEATTY. So the short answer is, if it were a yes or no, the answer is clearly, yes—

Mr. BERTSCH. Yes.

Mrs. BEATTY. —it hurts thousands of individuals?

Mr. BERTSCH. Right. There are many other provisions, but that is what I would focus on.

Mrs. BEATTY. Thank you. I yield back, Mr. Chairman.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentleman from Michigan, Mr. Kildee.

Mr. KILDEE. Thank you, Mr. Chairman.

And, again, thank you to the panel for participating in this hearing.

A hundred and seven years ago, Santayana wrote that those who cannot remember the past are condemned to repeat it. A little more recently, Stephen Hawking said, "We spend a great deal of time

studying history, which, let's face it, is mostly the history of stupidity."

The reason I mention that is that I find it almost impossible to comprehend that those advocating for this legislation fail to study even the most recent history of this country.

And as I said in my opening comments, I am now in my third term, but before I came here, I was working across the country, working with communities to try to breathe life back into abandoned properties. I founded an organization called the Center for Community Progress, still doing a lot of work in that field. And I saw, not just in my hometown of Flint, where chronic abandonment was the sort of predecessor to this episode of abandonment, but I saw strong communities, strong neighborhoods all across the country impacted in ways that, unfortunately, is not yet history.

Sure, this was a decade ago, but the impact on our Nation and on individuals, on families, is still being felt. The loss of the sole source in some cases, but the primary source of lifetime savings, the equity in their home, vanished. In a lot of places around the country, we are not even close to recovering the value that was lost.

And the consequence of that is significantly weakened communities, municipal governments that are struggling to try to provide basic public services, because the main source of revenue for those local governments has been the value of land and the ability to hold a community together and generate income, revenue, that can be put back into public services.

This is a crisis that is still ongoing. So when we talk about it, we have to resist the temptation to say we want to just miss another rerun of that history and realize we are still in the long tail of that crisis.

One area that I would like to get some comments on—and, Ms. Edelman, if you wouldn't mind beginning and then I will just see who else has something to say—I think we should be really clear about how this wrong choice act could put homeowners and potential new borrowers in a position of jeopardy.

Because for most Americans the way they understood the crisis was not big institutional failures or shareholder losses; it is that they lost their house. Or, their neighbor lost their house and that abandoned shell that was sold to some online speculator has undermined the value of their asset that they continue to support and pay their mortgage on and pay their taxes for. It wasn't just people who lost their houses, it was all the people who surround those empty places that have suffered big losses.

And I wonder, in the minute-and-a-half remaining, if you could start, Ms. Edelman, and just help us understand how this takes us back to a place where that could happen again?

Ms. EDELMAN. Yes. Thanks for your statement. And just one thing to underscore is that there are still over 7 million borrowers who are—homeowners who are underwater on their mortgages, a thousand counties in the United States where negative equity rates are either stuck or actually getting worse. So we are not through this crisis in many parts of the country.

In my mind, there are three or four main threats of the CHOICE Act to homeowners and homebuyers. First, mortgage servicing.

Part of the reason that the foreclosure crisis was as bad as it was is that we did not have servicing standards in place to deal with the volume of delinquent borrowers that we had. So the CFPB has written new mortgage servicing rules, which should help going forward. This bill would expand an exemption that is currently just for very small banks for some larger banks from those rules.

The second area that really concerns me is the provision of the bill, part of Title V, that would provide all sorts of freedom from any legal liability on any mortgage made even if it has risky features as long as the bank holds it on portfolio, and that is just not a good enough protection for homeowners. We learned that with Washington Mutual and Wachovia, which made plenty of lousy loans that they held on portfolio. It is not enough to protect consumers. And that, to me, is one of the provisions that truly keeps me up at night.

And, finally, the one that I will mention with the 6 seconds left, is provisions that would make it easier to steer manufactured housing borrowers into high cost loans. These are some of the most vulnerable of our consumers, and this bill would pose risk to them.

Mr. KILDEE. I appreciate that. And if I could just, on that issue of portfolio loans, I completely agree. We tried. There was a possibility we could have gotten something done. We tried to create some lanes to keep those products from going back to those exotic and dangerous exploding mortgages. But in an era of bipartisanship—which really doesn't exist—we couldn't get it done there too.

So thank you very, very much.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. And thank you to the panel for participating in this. I would really like to thank Ranking Member Waters for assembling this group and for doing this due diligence around a really important and threatening piece of legislation.

I am one of three Members sitting in the room who was here when we wrote Dodd-Frank and passed it, and we did it over many, many months, with hearing after hearing after hearing, including input from everybody, including representatives of the industries, consumer groups, unions, you name it. It was a lot of hard work. And here we have a major revision, maybe even a repeal of much of the work that we did back then, based on one hearing.

And here is the interesting thing. The theme that has been teased out today is that this repeal is being done in the service of the big banks and Wall Street, and I think there is something to that. But interestingly enough, when I look at the witnesses who actually participated in the hearing on April 26th, oddly, there are no big banks, there is no representative of Wall Street. Instead, let me just read you who was here: the Cato Institute; The Heritage Foundation; the American Enterprise Institute; the R Street Institute; and the Mercatus Center. Each and every one of these groups is a Libertarian think tank.

Now, there is a lot to be said about think tanks, but I think we would all agree that people who are in think tanks are not actually out there in the world regulating, doing things, participating in

this industry. And without exception, these think tanks, which were the only witnesses in the only hearing around the CHOICE Act, are dedicated to the idea that government should shrink almost to the vanishing point. I am reminded of Grover Norquist, who said he wants to starve the government of money so that it can be strangled in the bathtub.

Now, that, by the way, is a fair debate. This is why two parties exist. We should have a debate about how big government should or should not be. But in this area, this is a really dangerous instinct. We have 500 years-plus of history of what happens when you get leverage, fractional banking, when you get speculation in an unregulated environment, literally 500 years: the 17th century Dutch tulip bubble; the 18th century South Seas bubble; the 1929 crash, which devastated this country; the Japanese property bubble of the 1980s; the S&L crisis of the 1980s, and of course the catastrophe that led to 2008 and all of the effects that you have been so good at reminding us of.

All of those events happened because of this idea that you just do away with the regulated market, that when it was established in the 1930s created the stability that contributed to this country's middle-class growth. So I think it is a profoundly dangerous thing, and I want to just explore two areas.

Number one is, it hasn't been remarked on today, but one of the things the CHOICE Act would do would be to repeal Section 978 of Dodd-Frank, which provides a steady and predictable source of funding to the Government Accounting Standards Board (GASB). Now, we don't talk about it a lot, but these are the scorekeepers, these are the people who provide the financial statements that allow the municipal bond market to work. They are critical to the market, and of course this would, the CHOICE Act would repeal that provision.

Mr. Chairman, I would like to seek unanimous consent just to insert into the record a letter to Chairman Hensarling from a bunch of Members who happen to be CPAs, as well as from the National Governors Association.

Mr. HOLLINGSWORTH. Without objection, it is so ordered.

Mr. HIMES. Thank you.

And then, Professor Coffee, first of all, I want to thank you for the work you have contributed to our efforts here to deal with insider trading and make the law clear there. But I want to give you in my remaining minute and 20 seconds or so an opportunity to talk about the CHOICE Act's replacement of the orderly liquidation authority. This is the authority that when we are back in 2008, no one knows who has authority to do what, says now we have a regime.

I hear time and time again that bankruptcy suffices as a mechanism to deal with that kind of crisis. I don't happen to believe that is true. Can you just spend a minute telling us why bankruptcy, as normal firms think of it, does not work in the event of a financial crisis?

Mr. COFFEE. I want to be clear that I think there could be a robust bankruptcy provision that would be helpful and that would be a supplement, but it can't be a substitute. What we lose when we shut down orderly liquidation authority is basically four things.

We lose the regulator making the decision to shut the bank down. Instead, it will be shut down when the bank totally runs out of money. Lehman was shut down the last day it could stagger to get any money paid.

It will take much longer to shut down because the bank will wait until the last minute. So we will have bigger losses because there has been a longer period of insolvency.

Three, we will lose any access to liquidity. Most bank failures of large banks are probably more caused by liquidity failures than by complete insolvency. That is the simplest way to solve the problem, and the FDIC has done that with small banks for decades successfully.

Then, we lose accountability. Accountability is there under the liquidation authority, not there in the Bankruptcy Code. You can't hold these people liable.

My time is up.

Mr. HIMES. Thank you, Professor.

I yield back my time.

Mr. HOLLINGSWORTH. The gentleman yields back.

The Chair now recognizes the gentleman from California, Mr. Vargas, for 5 minutes.

Mr. VARGAS. Thank you very much, Mr. Chairman. And thank you for being here. I do appreciate it very much. And I also want to thank the ranking member for giving us this opportunity to question these witnesses.

And, of course, I thank the panel here today for being here and allowing us to hear from you and to ask you questions.

Now, I have to say that I think that the Dodd-Frank law has worked pretty well. I think that it has performed generally well. It is not perfect.

But the thing that really touched me today was something you said, Pastor Gable, which is that somehow we get the notion that poor people should pay more, that they should pay more for a car, that they should pay more for a home, frankly, they should pay more for food even, it is more expensive in the community, and I think that is wrong.

I do think we should love them more, I think that we should because they are the least among us. And I do believe in Canonized scripture. I know that my friend Mr. Sherman said a word about that, and I think more in line with Dodd-Frank. But I do believe in Canonized scripture, so I do think that we should love them more and I think we are obliged to do that and we should.

But the one question I did want to ask about, and it is a little bit touchy, but I think it is important, which is, I do hear from some of my constituents these days that it is hard to get a loan, and I do hear that. I heard a little bit different today that the loans are being originated, funded at a higher level. But I do hear still a significant amount, less than a few years ago, to be frank too, but I do hear people come and they say, "Look, I have a study job, I can prove that, I have the downpayment. Look, my credit score is high. I can show where I got my downpayment from. I am not hiding anything. I still can't get that loan."

Could you talk a little bit about that? And it seems, Ms. Edelman, you are chomping at the bit to get at it, so why don't you go ahead.

Ms. EDELMAN. Yes. No, I am glad that you raised the question, and I think that this is worth discussing, because—

Mr. VARGAS. That is why I mentioned it.

Ms. EDELMAN. Yes. In the housing market right now, credit is tight with respect to mortgages, but it has very, very little to do with Dodd-Frank. Last week, the Urban League hosted an event with civil rights groups, consumer groups, and two mortgage banking organizations, and all of them agreed on four major problems that are keeping access to credit too tight for most Americans.

Number one, GSE pricing. Right now there is a 350-basis-point difference between someone who applies for a loan at the higher end of the spectrum versus the lower end of the spectrum. If you have below a 700 credit score, you are not really going to get a loan that is bought by Fannie or Freddie. That is number one.

Number two is an issue around FHA and the funding that it has available to really finish what is called the taxonomy to help mortgage lenders understand sort of the rules of the road. There are some enforcement and regulatory issues on the FHA side that people are working on already on a bipartisan basis.

Number three is around credit score models. Right now your credit score is one of the major determinants of whether you can get an access to a loan. There are a lot of problems, and they are not all that representative of your credit risk.

Finally, the final issue that they all agreed on was that we need more resources to help get borrowers, people who want to buy homes ready for home ownership. That means help with downpayments. That means help repairing credit, because we just came out of a major crisis and recession, and it takes a while to repair the credit.

So there are a host of issues that are keeping our mortgage market from being accessible, but Dodd-Frank does not appear to be one of them.

Rev. GABLE. Congressman, in the area—and you are correct—of small dollar loans, there is that need. Now, we have attempted to close that vacuum with churches and our nonprofits. In concert with credit unions, they are making small dollar loans. Catholic Charities, National Baptist is establishing a national Federal credit union model, that we will hope to do that also, working with another Federal credit union to do small dollars.

It certainly has been our efforts through Faith and Credit Roundtable and Faith for Just Lending to talk with community banks to get back in the business of these smaller dollar loans.

Let me just say this: Those who are trying to get small dollar loans, it would be okay if the payday lenders who were doing it and the borrower was getting the same rate that the military gets, 36 percent. I believe that what is good for the military ought to be good for America.

Mr. VARGAS. My time has expired, unfortunately, but I was going to ask—thank you. Thank you, Mr. Chairman.

Mr. HOLLINGSWORTH. The Chair now recognizes the gentleman from Texas, Mr. Green, the ranking member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member as well. I especially thank her, because this panel is really what America looks like. And this is a rare occasion for us here in the Financial Services Committee.

So I thank all of you for being here today.

When we talk about homes being lost, we sometimes don't understand the pain associated with the loss. Suffering can teach you that which you can learn no other way. I saw the suffering. I saw the people who were evicted from their homes. But they were evicted also from their dreams. Their children were evicted from the schools that they were attending.

It was about more than a house. Many of these people had just purchased the home of their dreams, and many of them purchased that home based upon representations that were made to them by the person who helped them with the loan, that caused them to buy more than they could afford, when they qualified for less. They qualified for 5 percent, and they got homes for 8 percent, 9 percent, even higher.

And the person who sold them the loan for 9 percent got a kickback. They have a pleasant way of saying it, called the yield spread premium, but it was a kickback. It was a bait-and-switch scheme that allowed brokers to qualify people for 5 percent, smile in their faces and shake their hands, and say, "Good news, you have a loan for 10 percent," and never tell them.

In a righteous world, that would have been a crime. And the truth is this: We are about to go back to a circumstance that will allow this to happen again, and it won't be a crime. People will be taken advantage of.

I remember the circumstances were so bad such that banks would not lend to each other. They declined to accept the credit from each other. And at that time, there was something called proprietary trading, which means that the banks could take the deposits from hardworking Americans and move them over to the investment side and go out on Wall Street and gamble. And if you win, great, you get to keep the profits. Who is the "you" in this statement? The people who were making the investments, not the people who had the deposits in the bank.

I don't believe that most Americans would think that it is appropriate to take the money that they deposit in a bank, allow that to go over to the investment bankers and let them gamble on Wall Street, and if they win, they get to keep the profits, and if they lose—by the way, those funds are FDIC-insured. And they are FDIC-insured because at the time this was done, in 1933, I believe, or thereabouts, the deal that they cut was that if we allow the FDIC to insure these banks, you will have a firewall called Glass-Steagall, and Glass-Steagall will prevent the deposits from being used to gamble with on Wall Street.

That was the deal that was cut. The deal was broken, and we are about to break it again, because we are going to rid ourselves of the Volcker Rule with this Bad Choice Act, which is the wrong choice.

So I saw the pain and the suffering. And my hope is that by some miracle the Senate will stop what the House is about to do, because the Senate is a bit more deliberative and they have different rules.

But as you can see, the folks who are about to do this are not really concerned, because they are not here today. God bless them, I love them all, but I have to tell the truth. This is almost an insult to what we are trying to accomplish. And I hope that the camera is constantly panning the other side so that people can see the lack of interest in what we are trying to accomplish.

I don't have a question. I thank you, Mr. Chairman. And I yield back my time.

Mr. HOLLINGSWORTH. The gentleman yields back.

The Chair now recognizes the gentleman from Nevada, Mr. Kihuen, for 5 minutes.

Mr. KIHUEN. Thank you, Mr. Chairman.

And thank you to the ranking member as well for bringing us all together.

And thank you all for your presentations and being here to speak truth to power. It is very disappointing, looking at the other side, that only one of my colleagues from the other side of the aisle chose to be here to listen to your testimony.

I wish that they would visit my district. As you all know, Nevada was one of the hardest hit States in the country. Las Vegas was even harder hit. And my congressional district had the highest foreclosure rate in the country. And as we speak, people are still losing their homes.

And it is disappointing that I am coming here to Congress as a freshman to work in a bipartisan manner, to reach across the aisle to come up with solutions to keep my constituents in their homes, that we are going back to some of the same regulations that put them in a financial crisis to begin with. And this bill is going to do just that.

Look, I am more than happy to sit down with the other side and come up with solutions, but when we can't even get them at the table, it is very disappointing. How do you go back to your constituents and explain to them that they are losing their home, yet they are not doing anything to try to help keep them in their home.

So it is disappointing, but nevertheless, I appreciate each and every one of you for being here, for helping my constituents stay in their homes and for continuing to fight on behalf of the hard-working people who are still trying to make ends meet here in our country.

I do have a question. Ms. Edelman, what kind of important housing reforms contained in Dodd-Frank would this bill, the wrong choice act, undermine?

Ms. EDELMAN. The bill would undermine many of the protections put in place to prevent predatory mortgage lending. So after the crisis and after there were millions of predatory loans made, Congress put commonsense laws in place like, for instance, a lender needs to evaluate a borrower's ability to repay a loan before making it. They also put in place incentives to try and get lenders to make loans without high fees and risky features.

So overall they encourage a more affordable lending environment, and the wrong choice act basically would gut, would undermine some of those new rules, in particular the qualified mortgage rule. As I mentioned in response to an earlier question, it would allow banks to get sort of this—it would get legal liability protection on any loan even if it has risky features as long as they hold it on portfolio, which we HAVE found time and time again is not a reliable strategy. It makes manufactured housing consumers more vulnerable.

In addition to all of the large systemic issues that my colleagues have spoken to, it turns it back to a day where there was less trust between a buyer and a lender when you go into a bank. The Dodd-Frank Act has helped to reestablish some of that trust, and this proposal would really turn the clock back to the day where you don't want to send your mother or your kid or your grandmother in to get a mortgage loan.

Mr. KIHUEN. So is it fair to say that if this bill passes, we could potentially be facing another financial crisis in this country, and particularly a housing crisis in Nevada in my congressional district?

Ms. EDELMAN. I think that is right. I think that most of my colleagues would agree that this bill, that this proposal would put the United States financial system in a precarious situation, similar to where it was right before the crisis, and it would really undermine the stability of our housing market. And home ownership, as you know, is really the path to wealth for most families, it is where most of them have their family wealth, and we don't want to gamble with that, and this would gamble with that.

Mr. KIHUEN. When you talk about the American Dream, it entails owning a home, a car, having a good job, getting your kids a good education. When you spend all your savings in purchasing that home and because of the bad laws that we are passing here in Congress you end up losing your home, and then we are here in Congress and we are not even coming up with solutions to try to keep them in their homes, that is incomprehensible to me.

Ms. EDELMAN. That is right. And one thing to build on that is that in the crisis many people who got predatory loans were people who had owned their homes for decades, they had built equity in their homes, and they were tricked into refinancing into high interest rate loans that stripped them of their wealth. So it wasn't just people chasing after the American Dream, it was people who had achieved the American Dream and were in a position to pass that equity down to their kids, and they got derailed.

Mr. KIHUEN. Thank you.

Mr. CHOPRA. If I could just add that you see closely the physical look of boarded-up homes, of abandoned property due to foreclosure, but I think sometimes we forget the invisible wounds that are everywhere. When your child has to change a school and sit alone at the lunch table. When your kids are having a tough time sleeping because they see you worrying about your finances. When you have to lose the neighbor who is helping take care of your mom later. These wounds are scars, and they don't go away easily, and we can't forget them.

Mr. HOLLINGSWORTH. The gentleman's time has expired.

The Chair now recognizes the gentleman from Florida, Mr. Crist, for 5 minutes.

Mr. CRIST. Thank you very much, Mr. Chairman.

And I want to especially thank the ranking member. She made this hearing possible. So God bless you and thank you very much.

Democrats are united under her leadership to protect all Americans from the wrong choice act and having to relive one of the worst financial crises in our Nation's history.

I also want to thank the witnesses for agreeing to testify on such short notice. Thank you for your kindness.

As Governor of Florida, which, as you know, was ground zero for the foreclosure crisis, I witnessed firsthand how the policies that led up to the crisis hurt families, hurt my neighbors, hurt my friends in my hometown of St. Petersburg. Imagine for a moment playing by the rules as you know them, achieving a certain level of success, eventually you buy a home, you achieved the American Dream, only to have it ripped out from under you. You lose everything. No appeals. No second chances. Nothing. The financial crisis took $17 trillion of wealth away from the American people, from families, from children, from grandparents. I never want to see that happen again ever.

So I have a question. Ms. Liner, knowing all that we know about the crisis and what caused it, if the Dodd-Frank Wall Street Reform Act had been the law of the land in 2001, would it have prevented the crisis, in your view?

Ms. LINER. Thank you for your question.

What is really important about the Dodd-Frank Act is that it is proactive, it looks toward the future, about how can we make our banking system stronger, because we can reduce the likelihood of a crisis, and if we can reduce the amount of losses, whether they are financial or social losses, as we have spoken to both today, then we can prolong economic growth.

I hesitate to speculate if Dodd-Frank could have stopped the crisis, because it is hard to say, but Dodd-Frank would have lessened—

Mr. CRIST. Let me rephrase, then. Is it less likely that we would have had the crisis if Dodd-Frank were already in effect? Less likely.

Ms. LINER. I feel that we could say we could have reduced the probability that a crisis would have occurred and we could have reduced the losses that would have occurred in the crisis.

Mr. CRIST. If it had already been the law.

Ms. LINER. If it had already been the law.

Mr. CRIST. Thank you.

Professor Coffee, same question. Would Dodd-Frank have prevented the crisis?

Mr. COFFEE. I can't tell you it would have.

Mr. CRIST. I can't hear you. Sorry.

Mr. COFFEE. It would have armed regulators so they could have acted, if they had the courage and the foresight to do so. I think you would have had to take action by the beginning of 2008, well before Bear Stearns failed, and it could have been stopped, but I don't know that it would have been. It depends on human beings.

Mr. CRIST. Right.

Mr. RANDHAVA. If I could add to that. It would have provided a more streamlined place when it came to other concerns that groups like ours had about mortgage products that were out there with so many different regulators. Much to her credit, former FDIC Chairwoman Sheila Bair really did a good job of hearing us out, but when there were multiple regulators dealing with consumer protection, there was not a whole lot she could do single-handedly.

Mr. CRIST. All right. Thank you.

Ms. Liner, we are here to discuss the wrong choice act. Isn't that right?

Ms. LINER. That is correct, Congressman.

Mr. CRIST. Thank you. Okay, then, knowing all we know about the bill and the financial crisis, if the wrong choice act were the law of the land in 2001, would it have prevented a crisis?

Ms. LINER. On that question, I feel much more confident in my response, in that we would have really struggled to contain the losses of the financial crisis. It could have been much worse.

Mr. CRIST. Okay. Thank you.

Professor Coffee, would the wrong choice act have prevented the crisis, in your view?

Mr. COFFEE. I don't see any way in which the wrong choice act would have prevented a crisis. It would have left us about as exposed as we were at that time.

Mr. CRIST. Thank you both. That is all I need to know. The wrong choice act ought to be defeated, and it is going to affect real people in a real way. And you alluded to it, sir, in some of your comments, about how this will affect children, their ability to be able to be in a good learning environment, so many things that are many times unseen rather than the more obvious foreclosure on your home that is seen. It has an incredible effect. So God help us.

Mr. HOLLINGSWORTH. Does the gentleman yield back?

Mr. CRIST. Yes. I'm sorry. Forgive me.

Mr. HOLLINGSWORTH. The gentleman yields back.

The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

Professor Coffee, I am going to read you a statement and I am going to ask you to reconcile it with the wrong choice act, if you can. The statement is as follows: "If you are a bank and you want to operate like some nonbank entity, like a hedge fund, then don't be a bank. Don't let banks use their customers' money to do anything other than traditional banking."

Can you reconcile that statement with the contents of the wrong choice act?

Mr. COFFEE. No, I don't think I can.

Mr. HECK. Do you think the wrong choice act is highly violative of this statement, both in substance and in spirit?

Mr. COFFEE. You have just created a very prophylactic rule: If you are a bank, don't take a lot of risk. This statute would eliminate most of the risk-restricting provisions like the Volcker Rule, so they are contradictory.

Mr. HECK. So if Speaker Ryan, who uttered this statement at a townhall in front of his constituents, votes in favor of the wrong

choice act, he will in fact be violating what he said he thought ought to be the policy of this land?

Mr. COFFEE. I certainly see a tension.

Mr. HECK. All right.

This next question—I don't know to whom I should address it, so I will ask anyone who has a good answer—relates to an abiding concern of mine.

I have the great privilege to represent Joint Base Lewis-McChord, 55,000 people a day report to work there, most of them men and women in uniform. We are acutely aware of being vigilant on their behalf during times of armed conflict, but as our two theaters of armed conflict have declined in size and scope, I tend to think and worry that their welfare recedes from our uppermost thoughts. And indeed, as international tensions has risen, it is a good reminder that we cannot allow that to be the case.

One of the features of the Consumer Financial Protection Bureau is the Office of Servicemember Affairs. And I would like to ask anyone who can answer what you think the implication might be to the capacity of the CFPB to educate and protect the men and women who wear the uniform in furtherance of the security of this Nation and its ability, the agency's ability to protect their interest.

Mr. Chopra, you look like you are ready to get in, as a former employee of that agency.

Mr. CHOPRA. There is just no question that service members, veterans, and their families have been a target by so many bad actors in the marketplace. And under the leadership of Holly Petraeus and now Paul Cantwell you have seen an aggressive change about how military families are treated. We saw major enforcement actions across all the regulators targeting illegal foreclosures, illegal car repossessions, illegal debt collection, and illegal student lending.

And according to a report by the Department of Defense, a major reason for servicemembers leaving service is because of financial issues. Many lose their security clearances because of problems with debt. And the DOD even cites data suggesting that financial stress is a cost not only to increased costs due to retraining of new recruits, but it has real national security implications as well for morale and the strength of the force.

We need to make sure that the Military Lending Act, the Servicemember Civil Relief Act, and the CFPB with its dedicated military office, which has been lauded by the senior enlisted leadership of the military, stays intact and is strengthened.

Mr. HECK. So it would be fair and accurate for me to surmise from what you just said that you think both our Nation's security and the best interests of the men and women who wear the uniform on our behalf would be diminished by the passage of the wrong choice act?

Mr. CHOPRA. Absolutely. Senior enlisted leaders have made clear that they need the CFPB on their side, and this bill would essentially destroy that agency.

Mr. HECK. In the brief time I have left, I want to quote one of my favorite American philosophers, albeit he was Spanish-born, and that is, of course, George Santayana, who said, those who cannot remember the past are condemned to repeat it. Those who can-

not remember the past are condemned to repeat it. And if we do not learn the lessons of the Great Recession and its causes, then we will be condemned to repeat them, and passage of the wrong choice act will only hasten the repeat of those very, very painful experiences.

Thank you one and all for giving of your most precious commodity, your time, and being here with us today.

And with that I yield back, Mr. Chairman.

Mr. HOLLINGSWORTH. For what purpose does the gentlelady from California—

Ms. WATERS. I request unanimous consent to enter into the record a list of 138 groups that are opposing all or part of the CHOICE Act. These are the groups and I would like to enter them into the record. Thank you.

Mr. HOLLINGSWORTH. Without objection, it is so ordered.

The Chair now recognizes himself for 5 minutes to ask questions.

Ms. Liner, tell me a little bit about why regulators failed to recognize the crisis in advance or the potential for a crisis in advance?

Ms. LINER. Prior to the crisis, we did not have the Office of Financial Research, which was established by Dodd-Frank.

Mr. HOLLINGSWORTH. We certainly had many other regulators, though.

Ms. LINER. We did, but we didn't have a way for them to communicate with each other, because the FSOC wasn't in place.

Mr. HOLLINGSWORTH. So they knew about it individually and failed to communicate with each other about it?

Ms. LINER. The records show, the historical records show that all the regulators were looking at different parts of the financial system, and there was nothing in place for them to communicate.

Mr. HOLLINGSWORTH. So it begs the question, if they didn't know about it individually and then, I guess, as you say, couldn't share the information about it, why do we think more regulators will uncover these things if the regulators beforehand couldn't uncover them before the crisis?

Ms. LINER. Just to clarify, I think that the regulators in their spheres of the financial sector were aware of some of the issues that were bubbling up. It was the interconnectedness that really—

Mr. HOLLINGSWORTH. So it is not a matter that you are in favor of the more regulation that Dodd-Frank has put it, you just want to make sure that those regulators are better connected?

Ms. LINER. That is one aspect. We support smart regulation, and we think that Dodd-Frank is a modern smart regulation for the financial sector.

Mr. HOLLINGSWORTH. Tell me a little about, what do you think the total cost to the FDIC of a bank's trading book losses were in reference to the Volcker Rule. Because we hear a lot about from committee members and others that say that banks used deposits to then make bets, and when, in fact, it was the loan books that caused the significant amount of losses in each institution and it was not their trading books, in fact, at all. Can you specify how much the FDIC lost because of trading books of various institutions?

Ms. LINER. I don't have that information in front of me, but I would be happy to look it up and submit it for the record.

Mr. HOLLINGSWORTH. Please do. I think when you look it up, you will find that it was zero. In fact, zero FDIC dollars were mobilized because of the losses in trading books, but instead because of the immense losses in loan books. And I don't think we are asking banks to get out of the loan business because they made mistakes in their loan books, are we?

Ms. LINER. We, in fact, are hoping that banks continue to loan to consumers.

Mr. HOLLINGSWORTH. Right.

Ms. Edelman, earlier today, you talked about the inability of certain people with lower credit scores or who don't meet certain requirements to get loans. Could you expand upon that a little bit?

Ms. EDELMAN. Sure. Right now the average credit score for a loan that is purchased by Fannie Mae or Freddie Mac is about 740, which is significantly lower than the national average, which is under 700.

Mr. HOLLINGSWORTH. Right. Can you help me understand how the Dodd-Frank bill addressed that concern and enabled and empowered more individuals of moderate means to get loans?

Ms. EDELMAN. The GSE's have made a decision to price credit in this way. It doesn't have anything to do with Dodd-Frank.

Mr. HOLLINGSWORTH. Got it. So when I think about getting credit out to small businesses and I think about getting credit out to individuals of moderate means, right, I would want to ensure that there was a lower spread between those that have higher credit scores and lower credit scores, right?

Ms. EDELMAN. Correct.

Mr. HOLLINGSWORTH. I think that is what you were pushing for before. And how do we do that?

Ms. EDELMAN. I think that that is largely within the authority of the Federal Housing Finance Agency and the GSEs themselves, so I think that is a conversation to have with them. They have set the price—

Mr. HOLLINGSWORTH. So the answer is more government price controls, not getting more capital into the market so that we can get individuals loans that they need in order to service their businesses?

Ms. EDELMAN. Currently, the only reason we have private capital and that we have liquidity in the mortgage market is because of Fannie Mae and Freddie Mac.

Mr. HOLLINGSWORTH. Yes, a problem that Republicans on this committee are definitely trying to solve to ensure that we get private capital back into the markets.

I guess my last question is—I am certainly not a believer in perfect legislation, and someone else mentioned that as well—what are the issues with Dodd-Frank? What would you change about Dodd-Frank today?

Ms. EDELMAN. Is that question directed to me or to anyone?

Mr. HOLLINGSWORTH. Well, actually to the entire panel.

Ms. EDELMAN. Okay.

Mr. HOLLINGSWORTH. I guess the silence means everybody thinks Dodd-Frank is absolutely perfect?

Ms. EDELMAN. I will kick it off. I think that there is an ongoing process with regulators to make sure that regulations are tailored

in a way that works to banks. In the mortgage space, most of the things that need to be done, as I mentioned before—

Mr. HOLLINGSWORTH. So we are counting on regulators to cut their own power and their own reach and the bureaucracy to shrink itself instead of Congress to take upon the responsibility to trim back the bureaucracy—

Ms. EDELMAN. No. We are counting on them to do their job and to make sure that they are responding to what is happening on the ground.

Mr. HOLLINGSWORTH. You mean the job that they did right before the crisis in ensuring that they found the crisis and they told everybody about it?

Ms. EDELMAN. The CFPB wasn't around for the crisis.

Mr. HOLLINGSWORTH. So it is the new regulator that we need and these new individuals are going to do it?

Those are all the questions I have. I yield back.

Ms. JACKSON. I was going to say, I would just add that it is about preventing a regulatory patchwork, one of which we have seen before, and the pitfalls of having such. I think the CFPB in its current form, as independent as it is currently in its current being, allows for it to have the enforcement that it needs, the leverage that it needs to take on the actors that—

Mr. HOLLINGSWORTH. We can definitely agree that the regulatory patchwork has been a serious problem for the financial sector and certainly held back the amount of economic growth that we can have. I have heard time and time again from witnesses that because loan amounts are up or because economic growth is not zero, then suddenly that is a testament to Dodd-Frank adding economic growth, when in fact the counterfactual isn't zero economic growth, but should be the economic growth we thought would occur, especially coming out of such a deep recession.

I thank all the witnesses for their time.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is hereby adjourned.

[Whereupon, at 12:44 p.m., the hearing was adjourned.]

A P P E N D I X

April 28, 2017

Testimony of

Ken Bertsch

Executive Director

Council of Institutional Investors

Before the

Committee on Financial Services

United States House of Representatives

April 28, 2017

Hearing on Financial CHOICE Act

Dear Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

Good morning. I am Ken Bertsch, Executive Director, of the Council of Institutional Investors (CII or Council). The Council is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. We also have associate members that include a range of asset managers with more than $20 trillion in assets under management.

I appreciate the opportunity to appear before you today on behalf of the Council. I respectfully request that the full text of my testimony, including the attached Council's April 24th letter to the Chairman and the Ranking Member be entered into the public record.

Members of the Council include funds responsible for safeguarding assets used to fund the retirement benefits of millions throughout the U.S. They have a significant commitment to the U.S. capital markets, and they are long-term, patient investors due in part to the heavy commitment of most to passive investment strategies. As a result, issues relating to the U.S. financial regulatory system, particularly issues involving corporate governance and shareowner rights, are of great interest to our members.

We believe that in its current form, the Financial CHOICE Act, if enacted, would weaken critical shareholder rights that investors need to hold management and boards of public companies accountable, and that foster trust in the integrity of the U.S. capital markets.

Americans suffered enormously from Enron and other corporate scandals of 15 years ago, and even more from the failures of oversight that contributed to the 2008 financial crisis. Many Americans lost jobs, homes and retirement savings.

The bill would threaten prudent safeguards for oversight of companies and markets, including some sensible reforms made in the wake of Enron and the financial crisis to close critical gaps in regulation. Our April 24th letter to the committee chair and ranking member outlines troubling ways that the bill threatens fundamental shareholder protections. In particular, let me highlight five areas of concern.

First, the bill would set prohibitively costly hurdles on shareholder proposals. Provisions of the bill would require a shareholder wishing to put a proposal on a company's annual meeting ballot to own at least 1% of the stock for three years, compared to the current requirement of $2,000 worth of stock for one year. That dramatic change would, for example, raise the ownership threshold to file a single shareholder proposal to $7.5 billion at Apple, $3.4 billion at Exxon Mobil and $2.6 billion at Wells Fargo.

Second, the bill would roll back curbs on abusive pay practices. Under the provisions of the bill, shareholders would get an advisory vote on executive compensation only when there is an undefined "material" change in CEO pay. Most U.S. public companies currently offer investors say-on-pay votes annually. The bill would also limit clawbacks of unearned executive compensation.

Third, the bill would restrict the right of shareholders to vote for directors in contested elections for board seats. The provisions of the bill would bar the use of "universal proxy" cards that give

investors freedom of choice to vote for the specific combination of director nominees they believe best serves their interests.

Fourth, the bill would create an intrusive new regulatory scheme for proxy advisors that provide shareholders with independent research they need to vote responsibly. The provisions of the bill would drive up costs for investors, potentially compromise the independence of advisors and impinge on their ability to provide honest advice to clients, create barriers to entry and even drive some proxy advisors out of business.

And finally, the bill would shackle the Securities and Exchange Commission (SEC) with excessive and unworkable cost-benefit analysis requirements. Those provisions would severely undercut the SEC's ability to fulfill its mission to protect investors, police markets and foster capital formation.

Notwithstanding our strong opposition to many of the provisions in the bill, we stand ready to work cooperatively with this Committee, my fellow panelists and other interested parties to develop meaningful improvements in the U.S. financial regulatory system that best serve the needs of investors, companies and the capital markets.

Thank you, Mr. Chairman and Ranking Member Waters for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

ATTACHMENT

Via Hand Delivery

April 24, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Hearing on the Financial CHOICE Act of 2017[1]

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $20 trillion in assets under management.[2]

The purpose of this letter is to thank you for holding a hearing on the April 19 discussion draft of the Financial CHOICE Act of 2017 (Act) and to share with you a summary of our initial views. We have organized our comments under three general subject headings: (1) Protect Fundamental Shareholder Rights; (2) Promote Effective Disclosure and Reliable Financial Reporting; and (3) Safeguard the Independence of the U.S. Securities and Exchange Commission (SEC or the Commission).

We would respectfully request that this letter be included in the hearing record.

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[1] Financial CHOICE Act of 2017, H.R. ____, 115th Congress (discussion draft Apr. 19, 2017), *available at* https://financialservices.house.gov/uploadedfiles/choice_2.0_discussion_draft.pdf.

[2] For more information about the Council of Institutional Investors (CII) and our members, please visit CII's website at http://www.cii.org/about_us.

1. Protect Fundamental Shareholder Rights

Shareholder Proposals

CII opposes Section 844 of the Act because it would dramatically restrict the ability of shareowners to file proposals on important governance issues.

CII and its members have a deep interest in ensuring that Rule 14a-8,[3] the federal rule that governs shareholder proposals, is fair and workable for shareowners and companies.[4] The rule provides an orderly means to mediate differences between managers and owners, and we are mindful that many positive advances in U.S. corporate governance practices simply would not have occurred without a robust shareowner proposal process in place. For example:

- Shareholder proposals were the impetus behind the now standard practice—currently mandated by major U.S. stock exchanges' listing standards—that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance.

- In 1987, an average of 16% of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81% level of support on average. Ten years ago, less than 40% of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.

- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90% of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority voting proposals.

- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.[5]

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[3] 17 CFR 240.14a-8 - Shareholder proposals, Cornell U. L. School, LII, *available at* https://www.law.cornell.edu/cfr/text/17/240.14a-8 (last viewed Apr. 23, 2017).

[4] *See, e.g.*, Examining the U.S. Proxy Voting System: Is it Working for Everyone, Corporate Governance Roundtable, Hosted by Rep. Scott Garrett, 114th Cong (Nov. 16, 2015) (Statement of Amy Borrus, Interim Executive Director, Council of Institutional Investors), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/11_16_15_cii_Rep%20_Garrett_roundtable_submission_amy_borrus.pdf.

[5] *See, e.g.*, Ceres Investor Network on Climate Risk and Sustainability, The Business Case for the Current SEC Shareholder Proposal Process 6 (Apr. 2017) (on file with CII).

Section 844 of the Act would radically increase the regulatory hurdles for shareholder proposals. Current rules set a minimum $2,000 ownership requirement.[6] More specifically, Section 844(b) of the Act would require any shareholder wishing to put a proposal on a public company ballot to own at least 1% of the company's stock for a minimum of three years.

Section 844(b) of the Act would require, for example, an investor at Wells Fargo to own approximately $2.6 billion in shares in order to file a single proposal. At Apple, the largest U.S. company by market capitalization, a shareholder would have to own more than $7 billion of stock to file a single proposal. Even our largest public pension fund members rarely hold 1% of a public company.[7] In fact, based on holdings as of December 30, 2016, the only shareholders with eligibility to propose resolutions at Apple would be BlackRock, Vanguard, State Street, FMR, Northern Trust, Bank of New York Mellon, Berkshire Hathaway and T. Rowe Price. To our knowledge, none of these investors has ever presented a shareholder proposal at an annual meeting.

In addition, current rules require a shareholder to re-file a proposal only if it has received at least 3% of the vote on its first submission, 6% on the second and 10% on the third.[8] Section 844(a) of the Act would raise those thresholds to 6%, 15% and 30%, respectively.[9] Those hurdles could also knock out many important governance proposals that, if adopted, could enhance long-term shareowner value. The percentages of proposals since 2000 that are estimated to have fallen below the proposed thresholds are 13.3%, 31.5%, and 50.1%, respectively.

We agree with Anne Sheehan, director of corporate governance at the California State Teachers' Retirement System, the second largest U.S. public pension fund, and a CII member, that the provisions of Section 844 of the Act "would shut down the shareholder proposal process completely."[10] Shutting down shareholder proposals is likely to have unintended consequences, including shareowners more often availing themselves of the blunt instrument of votes against directors, and increased reliance on hedge fund activists to push for needed corporate changes.

Universal Proxies

CII opposes Section 845 of the Act because it appears intended to bar the SEC from issuing a final rule that would allow shareowners to freely vote for those board candidates they favor in a contested election.

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[6] 17 CFR 240.14a-8(b) Question 2.

[7] *See, e.g.*, Letter from Jack Ehnes, Chief Executive Officer, California State Teachers' Retirement System, to The Honorable Maxine Waters, Ranking Member, House Committee on Financial Services 1 (Apr. 20, 2017) ("While 1% may sound like a small amount, even a large investor like the $200 billion CalSTRS fund does not own 1% of publicly traded companies.") (on file with CII).

[8] 17 CFR 240.14a-8(i)(12).

[9] Financial CHOICE Act of 2017, § 844(a).

[10] Andrea Vittorio, Shareholder Advocacy Tool Shut Down in Republican Plan., Bloomberg BNA's Corp. L. & Accountability Rep., Apr. 19, 2017, at 2, *available at* https://www.bna.com/shareholder-advocacy-tool-n57982086844/.

The problem that the SEC's October 2016 universal proxy proposal[11] would resolve is a problem that was clearly articulated by the SEC's Investor Advisory Committee in 2013.[12] Namely, investors are currently disenfranchised in a proxy contest, to the extent they vote by proxy, because they have no practical ability to "split their ticket" and vote for the combination of shareowner nominees and management nominees that they believe best serve their economic interests.[13]

That view is reflected in our membership approved policies for director elections which states:

> To facilitate the shareholder voting franchise, the opposing sides engaged in a contested election should utilize a proxy card naming all management-nominees and all shareholder-proponent nominees, providing every nominee equal prominence on the proxy card.[14]

Some opponents of universal proxy cards contend their use would encourage more proxy contests or favor dissidents. We are unaware of any compelling empirical evidence indicating that universal proxies would favor shareowner-proponent board nominees over company-nominees (or the reverse).[15] As concluded in a recent expert analysis of the SEC proposal by attorneys with Fried Frank Harris & Jacobson LLP: "In our view, the universal proxy card mandate, if adopted, would not significantly affect the outcome of proxy contests or activist situations."[16]

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[11] Universal Proxies, Exchange Act Release No. 79,164, Investment Company Act Release No. 32,339 (proposed rule Oct. 26, 2016), *available at* https://www.sec.gov/rules/proposed/2016/34-79164.pdf.

[12] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots 2 (adopted July 25, 2013) ("shareholders [currently] have no practical ability to 'split their tickets' and vote for a combination of shareholder nominees and management nominees), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf; *see* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors, to Brent J. Fields, Secretary, Securities and Exchange Commission 3, 6-40 (Dec. 28, 2016) (Explaining in detail why the "proposal will facilitate the ability of shareholders to fully exercise their franchise by proxy by allowing them to vote for the combination of nominees of their choice"), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/12_28_16_comment_letter_SEC_universal_proxy.pdf; *see also* Carl Icahn, Statement Regarding SEC Proposal to Require Use of Universal Proxy Cards (Oct. 27, 2016) ("the introduction of the universal proxy card will eliminate needless voter confusion in contested elections, give shareholders greater freedom of choice, and hopefully end some of the gamesmanship employed by incumbent boards to keep shareholder-nominated directors out of the boardroom"), *available at* http://carlicahn.com/statement-regarding-sec-proposal-to-require-use-of-universal-proxy-cards/.

[13] *Id.*

[14] CII Policies, §2.2 Director Elections (updated Sept. 30, 2016), *available at* http://www.cii.org/corp_gov_policies.

[15] *See, e.g.*, Tatyana Shumsky, SEC Weighs Universal Proxy Vote Cards, Wall St. J., Feb. 19, 2016, at 1 (Quoting Michelle Anderson, associate director in the SEC's Division of Corporation Finance, that the universal proxy project is "'not about favoring the company of the dissident'"), *available at* http://blogs.wsj.com/cfo/2016/02/19/sec-weighs-universal-proxy-vote-cards/.

[16] Gail Weinstein et. al., Fried Frank Harris Shriver & Jacobson LLP, Expert Analysis, A Practical Assessment of the 'Universal Proxy Card' Plan, Law360 at 5 (Dec. 14, 2016) (emphasis removed), *available at* https://www.law360.com/articles/871184/a-practical-assessment-of-the-universal-proxy-card-plan.

We also agree with Keith F. Higgins, former SEC Director of Corporation Finance, who recently commented:

> What I haven't heard is a good answer to this simple question: *Why shouldn't a shareholder who votes by proxy have the same voting options as a shareholder who votes in person? Unless someone comes up with a good answer to that question, I think the Commission should move forward with the proposal*, although I note that a prohibition on doing so may be part of version 2.0 of the Financial CHOICE Act being considered by the House Financial Services Committee. Even though there are only a relatively small number of contested elections each year, *it is a glitch in the system of fair suffrage that should be fixed.*[17]

Say-on-Pay

CII opposes Section 843 of the Act because it would reduce the required frequency of shareholder advisory votes on executive compensation, commonly called say-on-pay votes.

The requirements of Section 951, "Shareholder Vote on Executive Compensation Disclosures," of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), as implemented by the SEC, are generally consistent with CII's membership-approved corporate governance policies.[18] Those policies state:

> All companies should provide annually for advisory shareowner votes on the compensation of senior executives.[19]

While the requirement provides for say-on-pay votes to be held annually, biennially, or triennially, to date over 90% of public companies have opted for annual votes consistent with our policy.[20] Voting trends, investor preferences and results from our member survey indicate that support for annual say-on-pay in 2017 will be at or above that level.[21]

An annual say-on-pay vote is critical to investors, in part, because it provides shareowners with the ability to communicate their views on the most recent payouts stemming from the policies used to administer executive compensation practices. Those payouts may change in unforeseeable and unexpected ways due to a policy's complexity, reliance on forward-looking factors and board discretion.

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[17] Keith F. Higgins, Keynote Address at the Practicing Law Institute Corporate Governance – A Master Class 2 (Mar. 9, 2017) (emphasis added) (on file with CII).
[18] §5.2 Advisory Shareowner Votes on Executive Pay
[19] *Id.*
[20] CII, Say-On-Pay Frequency: A Fresh Look 1 (Dec. 2016), *available at* http://www.cii.org/files/publications/misc/12_22_16_SOP_Frequency_Report_Formatted.pdf
[21] *Id.*

It is now widely recognized that an annual vote on executive compensation has resulted in a number of ongoing improvements to the process in which corporate boards determine executive pay, including:

- Boards are actively and frequently reaching out to shareowners to solicit their concerns about, and their approval of, executive compensation plans;
- Boards are increasing the proportion of executive compensation linked to company performance, leading to potentially greater alignment between the two; and
- Boards are eliminating executive compensation perks such as club memberships that blur the line between personal and business expenses.[22]

Proxy Research

CII opposes Section 482 of the Act because it would establish an additional federal regulatory superstructure for proxy advisory firms that institutional investors, the primary customer of those firm's research services, do not want or need.

Proxy advisory firms play a vital and necessary role in assisting many pension funds and other institutional investors in carrying out their fiduciary duty to vote proxies. By law, pension fund fiduciaries have a duty to ensure that their proxies are voted in the best long-term interests of plan participants and beneficiaries. Many pension funds and other institutional investors contract with proxy advisory firms to obtain and review their research. But most large holders vote according to their own guidelines and policies.

Last September a letter co-signed by 30 CII members and other organizations expressed concerns about the Act's proxy advisory firm provisions.[23] Those provisions and our specific related concerns remain the following:

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[22] *See, e.g.*, Paul Hodgson, Surprise Surprise: Say on Pay Appears to Be Working, Fortune.com, July 8, 2015, *available at* http://fortune.com/2015/07/08/say-on-pay-ceos/.

[23] *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate et al. (Sept. 6, 2016), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/September%206%20Letter%20to%20Senate%20Banking%20on%20Proxy%20Advisory%20Firms.pdf; Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services et al. (June 13, 2016) (letter co-signed by 27 CII members and other institutional investors strongly opposing H.R. 5311), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/06_13_16_FINAL_Letter_on_Proxy_Advisory_Firm_Bill.pdf; *see also* Editorial, Undermining Proxy-Voting Advice, Pensions & Invs., June 27, 2016, at 1 ("A bill pending in Congress would undermine proxy-voting firms and consequently weaken the capability of asset owners and other institutional investors to bring to bear their crucial resources to assist in voting on proxy issues at publicly traded companies") (registration required & on file with CII), *available at* http://www.pionline.com/article/20160627/PRINT/306279998/undermining-proxy-voting-advice.

Require that proxy advisory firms (1) provide companies advance copies of their recommendations and most elements of the research informing their reports, (2) give companies an opportunity to review and lobby the firms to change their recommendations, and (3) establish a heavy-handed "ombudsman" construct to address issues that companies raise.

This right of pre-review would give companies substantial influence over proxy advisory firms' reports, potentially undermining the objectivity of the firms' recommendations. On a practical level, this right of review would delay pension funds and other institutional investors' receipt of the reports and recommendations for which they have paid.

The requirement that the proxy advisory firms resolve company complaints prior to the voting on the matter would create an incentive for companies subject to criticism to delay publication of reports as long as possible. Pension funds and other institutional investors would have less time to analyze the reports and recommendations in the context of their own customized proxy voting guidelines to arrive at informed voting decisions. Time already is tight, particularly in the highly concentrated spring "proxy season," due to the limited period between company publication of the annual meeting proxy statement and annual meeting dates.

Moreover, the proposed legislation does not appear to contemplate a parallel requirement that dissidents in a proxy fight, or proponents of shareowner proposals, also receive the recommendations and research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and dissident shareowners should operate on an even playing field.

Require the Securities and Exchange Commission (SEC) to assess the adequacy of proxy advisory firms' "financial and managerial resources."

The entities that are in the best position to make these types of assessments are the pension funds and other institutional investors that choose to purchase and use the proxy advisory firms' reports and recommendations. In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents. We publicly supported that guidance. We are unaware of any compelling empirical evidence indicating that the guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.

. . . .

The proposed legislation would appear to result in higher costs for pension plans and other institutional investors – potentially much higher costs if investors seek to maintain current levels of scrutiny and due diligence around proxy voting.

> Moreover, the proposed legislation is highly likely to limit competition, by reducing the current number of proxy advisory firms in the U.S. market and imposing serious barriers to entry for potential new firms. This would also drive up costs to investors. Given these economic impacts, we are troubled that there appears to be no cost estimate on the provisions of this proposed legislation.[24]

Our views are consistent with those of former SEC Director of Corporation Finance Keith F. Higgins who recently commented:

> Under this regime, proxy advisory firms would be required to register with the Commission, allow companies to review their reports before issuance, disclose potential conflicts of interest and provide financial reports. Although I don't dismiss concerns about the influence of proxy advisory firms, *I don't think the proposed regulatory regime is the answer*. Part of the problem in the industry is a lack of competition. For example, various sources report that the two largest players, ISS and Glass Lewis, control approximately 97% of the proxy advisory services market. It is unclear how added regulatory burdens will help promote competition. Typically, imposing additional regulation is a costly impediment to new entrants, and in turn, may bolster the incumbents' market position.
>
> *It is interesting that the clients who use proxy advisory reports don't seem to be complaining*. In fact, they often favor the ease, readability, and comparability of the reports.
>
> . . . .
>
> *I don't think placing an additional regulatory support superstructure on proxy advisory firms is the solution.*[25]

2. Promote Effective Disclosure and Reliable Financial Reporting

Clawbacks

CII opposes Section 849 of the Act because it would narrow the required scope for clawbacks of unearned compensation from corporate executives to those we had control or authority over the company's financial reporting.

We continue to support the SEC's issuance of a final rule in response to Section 954 of Dodd-Frank entitled, "Recovery of Erroneously Awarded Compensation." The SEC's proposed rule to

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[24] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate et al. at 8-10 (footnotes omitted).

[25] Keith F. Higgins at 2-3.

implement Section 954 is generally consistent with CII's membership approved corporate governance policies.[26] Those policies state:

> The compensation committee should ensure that sufficient and appropriate mechanisms and policies (for example, bonus banks and clawback policies) are in place to recover erroneous bonus and incentive awards paid in cash, stock or any other form of remuneration to current or former executive officers, and to prevent such awards from being paid out in the first instance. Awards can be erroneous due to acts or omissions resulting in fraud, financial results that require restatement or some other cause that the committee believes warrants withholding or recovering incentive pay. Incentive-based compensation should be subject to recovery for a period of time of at least three years following discovery of the fraud or cause forming the basis for the recovery. The mechanisms and policies should be publicly disclosed.[27]

Consistent with our policies, we believe the final SEC rule should, as proposed,[28] apply broadly to the compensation of all current or former executive officers whether or not they had control or authority over the company's financial reporting.[29] As we explained in our comment letter to the SEC:

> In our view, establishment of a broad clawback arrangement is an essential element of a meaningful pay for performance philosophy. If executive officers are to be rewarded for "hitting their numbers"—and it turns out they failed to do so—the unearned compensation should generally be recovered notwithstanding the cause of the revision.[30]

We note that if the limitation of Section 849 were adopted, employees such as the former head of community banking at Wells Fargo, Carrie L. Tolstedt, would presumably not fall under the scope the required clawback.[31] Finally, we note that our support for a broad clawback policy appears to be consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies, including Mary Barra,

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[26] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed rule July 14, 2015), *available at* https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.

[27] § 5.5 Pay for Performance.

[28] *See* 80 Fed. Reg. at 41,153 ("the compensation recovery provisions of Section 10D apply without regard to an executive officer's responsibility for preparing the issuer's financial statements").

[29] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 5 (Aug. 27, 2015), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/08_27_15_letter_to_SEC_clawbacks.pdf;

[30] *Id.* (footnotes omitted).

[31] Nathan Bomey & Kevin McCoy, Wells Fargo clawing back $75.3 million more from former execs in fake accounts scandal, USA Today, April 10, 2017, at 1 (reporting that "the bank has canceled $47.3 million in additional stock options owed to Carrie Tolstedt, who previously headed the community banking division where the scandal erupted"), *available at* https://www.usatoday.com/story/money/2017/04/10/wells-fargo-compensation-clawback/100276472/.

General Motors Company; Jamie Dimon, JPMorgan Chase; Jeff Immelt, GE; and Lowell McAdam, Verizon.[32] Those principles state that "companies should maintain clawback policies for both cash and equity compensation" of management.[33]

Hedging

CII opposes Section 857(a)(25) of the Act because it would repeal the requirement that public corporations disclose whether their employees and directors can hedge their company's equity compensation.

We continue to support the SEC's issuance of a final rule in response to Section 955 of Dodd-Frank entitled, "Disclosure Regarding Employee and Director Hedging." The SEC's proposed rule to implement Section 955[34] has important implications for CII's long-standing membership approved corporate governance policies on hedging of compensation.[35] Those policies state:

> Compensation committees should prohibit executives and directors hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity based awards granted as long-term incentive compensation or other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.[36]

For those companies that have not yet fully adopted our policy, we believe that a final SEC rule, as proposed, would provide our members and other investors with a more complete understanding regarding the persons permitted to engage in hedging transactions and the types of hedging transactions allowed. Armed with the proposed disclosure, our members and other investors would be in a better position to make more informed investment and voting decisions, including voting decisions on proposals to adopt hedging policies, advisory votes on executive compensation and voting decisions in connection with the election of directors.

We, like the SEC, "are not aware of any reason why information about whether a company has policies affecting the alignment of shareholder interests with those of employees and directors would be less relevant to shareholders of an emerging growth company or a smaller reporting company than to shareholders of any other company."[37] Moreover, we generally agree with the SEC that given its narrow focus, it is unlikely that the proposed disclosure would "impose a significant compliance burden on [those] companies."[38]

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[32] Commonsense Corporate Governance Principles VII(g) (July 2016), *available at* http://www.governanceprinciples.org/.
[33] *Id.*
[34] Disclosure of Hedging by Employees, Officers, and Directors, 80 Fed. Reg. 8486 (proposed Feb. 17, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-02948.pdf.
[35] § 5.8d Hedging.
[36] *Id.*
[37] 80 Fed. Reg. at 8494.
[38] *Id.*

Finally, we believe the proposed disclosure also would benefit our members and other investors because the public nature of the required disclosure would result in more public companies adopting our hedging policy and enhancing long-term shareowner value. For all the above reasons, CII generally supports the issuance of a final rule as proposed.[39]

Chairman & CEO Structures

CII opposes Section 857(a)(31) of the Act because it would repeal required disclosures of public corporation's Chairman and CEO structures.

We note that the SEC adopted rules in December 2009 that, in effect, implemented the disclosure requirements of Section 972 of Dodd Frank entitled, "Disclosures Regarding Chairman and CEO Structure." CII's membership approved policies generally support appointment of an independent chair. Those policies state:

> The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

CII members believe that the board leadership is critical to effective governance. We believe that even those who promote combination of chair and CEO roles generally share that view, and should have no objections to a disclosure requirement providing for clarity around the reasoning behind board leadership structure.

Finally, we note that our support for this disclosure appears to be consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies.[40] Those principles state that "board should explain clearly (ordinarily in the company's proxy statement) to shareholders why it has separated or combined the roles."[41]

Internal Controls

CII opposes Sections 441 and 847 of the Act that would further expand the existing exemptions for public corporations from having an external, independent auditor attest to, and report on, management's assessment of internal controls over financial reporting as generally required by

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[39] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent Fields, Secretary, U.S. Securities and Exchange Commission 3 (Apr. 16, 2015), *available at* https://www.sec.gov/comments/s7-01-15/s70115-5.pdf.

[40] Commonsense Corporate Governance Principles at V(a).

[41] *Id.*

Section 404(b) of the Sarbanes-Oxley Act. As explained in a joint letter from CII and the Center for Audit Quality in response to a recent SEC proposal:

> We believe that any amendment that erodes Section 404(b) would substantially impact the quality of financial reporting by public companies to the detriment of investors and our capital markets more generally . . . We believe Section 404(b) continues to be significant as it provides investors with reasonable assurance from the independent auditor that a company maintained effective internal control over financial reporting. This assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets. A Government Accountability Office report found that companies exempted from Section 404(b) experience more financial restatements, as compared to nonexempt companies; and the percentage of exempt companies restating has generally exceeded that of nonexempt companies. According to this report, companies that obtained an auditor attestation generally had fewer financial restatements than those that did not.
>
> Complying with Section 404(b) has a benefit for issuers. Academic research has demonstrated that the cost of capital for companies that voluntarily comply with Section 404(b) is lower than peer companies and has decreased for public companies since enactment of the Sarbanes-Oxley Act, especially for smaller companies.
>
> Lastly, while the cost of compliance with Section 404(b) is often cited as a concern by issuers, an SEC study concluded that such costs have declined by approximately 30% after the PCAOB adopted Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and the SEC issued management guidance on Section 404(a) in 2007.[42]

Governmental Accounting Standards Board (GASB)

CII opposes Section 857(a)(34) of the Act that repeals an existing market-based accounting support fee for the GASB. As we explained in a recent letter to you:

> On behalf of . . . CII, we write to urge you exclude from the Financial CHOICE Act any provision that repeals section 978 of . . . Dodd-Frank . . . that provides a funding mechanism for the . . . GASB.
>
> . . . .
>
> The GASB funding mechanism currently in place provides the GASB with an independent, conflict-free source of funds in order to carry out its important mission

[42] Letter from Cynthia M. Fornelli, Executive Director, Center for Audit Quality & Jeff Mahoney, General Council, Council of Institutional Investors, to U.S. Securities and Exchange Commission 2-3 (Aug. 30, 2016) (footnotes omitted), *available at* https://www.sec.gov/comments/s7-12-16/s71216-17.pdf.

> of establishing accounting and financial reporting standards for U.S. state and local governments that follow Generally Accepted Accounting Principles (GAAP).
>
> The independent and predictable source of funds that GASB receives benefits taxpayers and investors because it is free of the conflicts of interest, real or perceived, that were inherent in GASB's old funding source that required GASB's parent, the Financial Accounting Foundation, to solicit voluntary contributions from the very entities that would be bound by its accounting standards. We should not go back to this practice that undermines investor confidence.
>
> We support the GASB's important work and urge you to exclude any provision in your legislation that repeals GASB's current funding mechanism.[43]

3. Safeguard the Independence of the SEC

SEC Rulemaking

CII would amend Sections 311 and 334 of the Act to remove the SEC from the cost-benefit analysis and Congressional review provisions of Title III, Subtitle A and B of the Act, respectively.

As an association of long-term shareowners interested in maximizing share values, we believe it is vital to avoid unnecessary regulatory costs. However, it is not clear to us how the provisions of the Act would improve the cost-effectiveness of the SEC's existing rulemaking process or benefit long-term investors, the capital markets or the overall economy.

We note, for example, that the Act's provisions do not contain any language that would explicitly require the SEC to consider the costs and benefits of a proposal or rule from the perspective of long-term investors. Moreover, as we explained in a recent letter to Speaker Ryan and Minority Leader Pelosi regarding similar cost-benefit provisions of H.R. 78:

> The Commission's rulemaking process is already governed by a number of legal requirements, including those under the federal securities laws, the Administrative Procedure Act, the Paperwork Reduction Act of 1980, the Small Business Regulatory Enforcement Fairness Act of 1996 and the Regulatory Flexibility Act. Moreover, under the federal securities laws, the SEC is generally required to consider whether its rulemakings are in the public interest and will protect investors and promote efficiency, competition and capital formation.

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[43] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services, U.S. House of Representatives 1-2 (Feb. 9, 2017) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/February%209,%202017%20GASB.pdf.

> Since the 1980s, the Commission has conducted, to the extent possible, an analysis of the costs and benefits of its proposed rules. The SEC has further enhanced the economic analysis of its rulemaking process in recent years. That process is far more extensive than that of any other federal financial regulator.
>
> . . . .
>
> The [cost-benefit] provisions . . . would create a false and misleading expectation that the SEC can reasonably measure, combine and compare the balance of all costs and benefits of its proposals consistent with its mandate to protect investors. As explained by Professor Craig M. Lewis, former chief economist and director of the SEC's Division of Economic and Risk Analysis: "[W]ith regard to investor protection, the Commission is often unable to reasonably quantify the related benefits or costs."
>
> [The cost-benefit provisions] . . . would impose upon the SEC a costly, time consuming and incomplete analysis in which the Commission would be hard pressed to determine that the benefits of a proposal or rule "justify the costs of the regulation."[44]

The application of the Act's Congressional review provisions to SEC rulemaking is perhaps even more troubling for long-term investors. On this issue, we generally agree with the following comments of Broc Romanek of the TheCorporateCounsel.net:

> The "Financial Choice Act" is much more than merely repealing big chunks of Dodd-Frank. There are a handful of provisions that would render the SEC's ability to conduct rulemaking much more difficult. But this provision in particular . . . just blows me away:
>
> . . . A joint Congressional resolution to adopt a "major" rule – and even some non-major ones! [Its] goal appears to be neutering the so-called "independent" federal agencies that govern our financial institutions & markets. Talk about putting partisan politics into "independent" agencies. And here I was worried that having Congress involved in the SEC's budget process was too much meddling with a federal agency!
>
> Remember that federal agencies are part of the executive branch of government. Not to mention that members of Congress don't have the expertise, resources or time to understand what the various rules of an agency are. This would be a major windfall for lobbyists who would be able to effectively pay Congress to stop an agency from doing anything. Either the Senate or the House could stop a

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[44] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, United States House of Representatives et al. 2-3 (Jan. 11, 2017) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/01_11_17_letter_house_leadership_HR78.pdf.

> rulemaking – by simply sitting on their hands. The polar opposite of needing an "Act of Congress" to change something. It's brazen & breathtaking – and a whole lot of other things that I can't mention in this family-oriented blog.[45]

We believe the Title III, Subpart A and B provisions, individually, and particularly when combined, would unnecessarily constrain the ability of the SEC to issue any substantive proposals in furtherance of its mission to protect investors—the element of its mission that, in our view, is most critical to maintaining and enhancing a fair and efficient capital market system.

Compensation Structure

CII opposes Section 857(a)(26) of the Act because it would repeal requirements to improve executive pay practices at financial institutions.

We continue to support the issuance of a final rule by the SEC and the federal financial regulators in response to Section 956 of Dodd-Frank titled, "Enhanced Compensation Structure Reporting." As we stated in our comment letter in response to the federal financial regulators proposed rule to implement Section 956,[46] the proposal is "largely consistent with CII's member-approved policies on executive compensation."[47] Those policies support reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term, consistent with a company's investment horizon.[48] In light of those policies and the experience of the financial crisis,[49] our comment letter concludes:

> [We support] the proposed rule's over-arching requirements that incentive-based compensation arrangements at covered financial institutions 1) appropriately balance risk and reward, and 2) bar arrangements that could encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. We also support the proposed rule's recognition of the board's important role to oversee incentive-based compensation programs.[50]

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[45] Broc Romanek, Financial CHOICE Act: One Provision Could Destroy the SEC's Rulemaking, TheCorporateCounsel.net Blog (Nov. 17, 2016), *available at* https://www.thecorporatecounsel.net/misccnet/bio.htm.

[46] Incentive-Based Compensation Arrangements, 81 Fed. Reg. 112 (proposed rule June 10, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-06-10/pdf/2016-11788.pdf.

[47] Letter from Glenn Davis, Director of Research, Council of Institutional Investors, to Patrick T. Tierney, Assistant Director, Department of Treasury, Office of the Comptroller of the Currency, Legislative and Regulatory Activities Division et al. 2 (July 15, 2016), *available at* http://www.federalreserve.gov/SECRS/2016/July/20160721/R-1536/R-1536_071516_130346_394428687994_1.pdf.

[48] § 5.1 Introduction.

[49] Investors Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009) (concluding that the global financial crisis resulted, in part, from "too many boards approv[ing] executive compensation plans that rewarded excessive risk-taking"), *available at* http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

[50] Letter from Glenn Davis at 3.

We believe the issuance of a final rule, as proposed, appropriately preserves a role for incentive-based compensation at financial institutions and places a greater emphasis on risk management and long-term outcomes. The result should be greater stability for the overall market.

Proxy Access

CII opposes Section 857(a)(30) of the Act that would repeal authority of the SEC to issue a proxy access rule.

We believe that proxy access—a mechanism that enables shareowners to place their nominees for director on a company's proxy card—is a fundamental right of long-term shareowners. Proxy access gives shareowners a meaningful voice in board elections. Without effective proxy access, the director election process at many companies simply offers little more than a ratification of management's slate of nominees.

Our member-approved policy on proxy access states, in part:

> Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least 3% of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years.[51]

We also generally support an approach to proxy access similar to the one that the SEC adopted in 2010 but was later vacated after a court challenge. Now, more than 400 U.S. public companies have adopted proxy access in a form generally consistent with our policy.[52] That includes 11% of the Russell 3000, constituting more than half of the index's total market capitalization, and about half of the S&P 500.[53]

The companies that implemented proxy access are from a variety of industries. They include Intercontinental Exchange (the parent company of the New York Stock Exchange), Apple, United Airlines, CarMax, JPMorgan Chase and Apache.

Relying on private ordering rather than a uniform approach envisaged by the SEC in 2010 has led to myriad versions of proxy access, at greater legal expense than with a uniform rule, and with the potential for various creative provisions that seem aimed at making it difficult for shareowners to use the mechanism.[54] Given the clear growing trend of public companies adopting proxy access, and the increasing complexity and related costs resulting from the current private ordering process, there may soon come a time when companies and their shareowners will favor a more uniform, less costly set of standards and requirements for proxy access. If that

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[51] § 3.2 Access to Proxy.
[52] CII, Proxy Access by Private Ordering (Feb. 2017), *available at* http://www.cii.org/files/publications/misc/02_02_17_proxy_access_private_ordering_final.pdf.
[53] *Id.*
[54] *See id.* at 10.

time should arrive, Section 971 would facilitate the SEC's ability to respond with rule-making in a more cost-effective manner.

Private Equity

CII opposes Section 858 of the Act because it would remove transparency in private equity by requiring the SEC to exempt advisors to private equity funds from registration and reporting.

We continue to agree with the 2009 recommendation of the Investor Working Group that all investment managers of funds available to U.S. investors, including private equity funds, should be required to register with the SEC as investment advisers and be subject to oversight and disclosure requirements.[55] As has been widely reported, the existing registration and reporting requirements for advisers to private equity funds has led "firms such as KKR, Blackstone and Apollo Global Management LLC Group to [pay] . . . tens of millions in fines . . . after SEC examinations uncovered what regulators said were insufficient disclosures of some fee and expense practices to clients."[56] We believe that the Act's provisions to eliminate registration and reporting requirements for advisors to private equity funds would harm the SEC's investor protection efforts, disadvantage fund managers that currently follow best practices, as well as expose long-term investors and all taxpayers to potentially greater financial stability risks.[57]

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Thank you for considering our initial views on the Act. We would be very happy to discuss our perspective on these and other issues with you or your staff at your convenience. I am available at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

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[55] Investors Working Group at 16 ("All investment advisers and brokers offering investment advice should have to meet uniform registration requirements, regardless of the amount of assets under management, the type of product they offer or the sophistication of investors they serve[] [e]xemptions from registration should not be permitted").
[56] *See, e.g.*, Melissa Mittelman, Private Equity Eyes Tax and Financial Reform in the Trump Era, Bloomberg, Jan. 19, 2017, at 3, *available at* https://www.bloomberg.com/news/articles/2017-01-19/with-close-trump-ties-private-equity-eyes-tax-financial-reform.
[57] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, Speaker, United States House of Representatives et al. 1-2 (Sept. 7, 2016) (opposing proposed legislation that would roll back transparency and reporting requirements for private equity funds because it would inhibit the ability to monitor systemic risk and protect investors), *available at* www.cii.org/files/issues_and_advocacy/correspondence/2016/Sept%207%202016%20Letter%20to%20Speaker%20regarding%20H%20R%20%205424%20(003).docx%20(final).pdf.

Testimony of Professor John C. Coffee, Jr.

Adolf A. Berle Professor of Law at

Columbia University Law School

Before the House Financial Services Committee

On April 28, 2017

"Simple Truths For a Complex Financial World"

Because I was requested only a day ago to testify, I can cover only the major points in my written testimony, and I thus will not touch on a score of other objections that might be raised to the latest version of the "Financial CHOICE Act of 2017." My goal is to keep it simple.

A. THE SYSTEMIC RISK MACRO ISSUES:

In my judgment, the key issues (and deficiencies) of this legislation are:

(1) The CHOICE Act's replacement of "Orderly Liquidation Authority" with a very modest revision of the Bankruptcy Code is the most important and questionable change mandated by the Act;

(2) Ranking second is the CHOICE Act's "off-ramp" provision, which will allow most banks to escape the substantive provisions of Dodd-Frank if they can meet a single metric (an admittedly ambitious leverage test);

(3) The elimination of the Volcker Rule, which bars banks from proprietary trading, will also increase systemic risk for the future;

(4) Less noticed but still very important is the CHOICE Act's elimination of the Treasury Department's Exchange Stabilization Fund, which was the only (if imperfect) means by which the Treasury was able to avert a major panic in money market funds during the 2008 crisis. We may not be so lucky next time in the absence of this fund;

(5) The CHOICE Act's repeal of "Financial Market Utilities" effectively means that clearinghouses (both for securities and derivatives) will go largely unregulated and cannot be saved from collapse if they become insolvent in a crisis. The failure of a clearinghouse would be more serious than the near failure of AIG;

(6) The repeal of the Financial Stability Oversight Council's ("FSOC") ability to classify a non-bank as a "systemically important financial institution" (or "SIFI") means that in the future institutions that might parallel the scale of AIG in 2008 will escape needed oversight; and

(7) By repealing (for the most part) Dodd-Frank's "risk retention rules," the CHOICE Act means that securitizers can return to a "originate to distribute" model, and that invites reckless behavior.

I. The Elimination of "Orderly Liquidation Authority" ("OLA")

Section 111 of the CHOICE Act repeals OLA in favor of a bankruptcy alternative. I do not doubt for a moment that a robust bankruptcy alternative to OLA could be desirable, at least as a supplementary option. But the U.S. financial sector has geared up for several years now—through "living wills" and other means—to adapt to, and prepare for, OLA, and this bill will pull the rug out from under that careful and deliberate planning. This is a leap without a parachute. Even worse, this substitution has three dramatically adverse consequences:

(a) Lack of Role for the Regulator. There is no meaningful role for any regulator (FDIC, Federal Reserve, or OCC) in this bankruptcy alternative. Bankruptcy can be initiated by the debtor or creditors, but regulators are rendered impotent and left to observe from the sidelines. This undercuts the value of "living wills" and other provisions, which are intended to arm and inform the regulator. Instead, an unprepared and uninformed bankruptcy judge, with no staff, will be asked to make the critical decisions. Thus, a regulator who sees that a bank is likely to fail can only wait (or perhaps criticize from afar). As a practical matter, this implies that necessary interventions will be delayed. A failing bank is likely to hide its condition and file for bankruptcy only at the last possible moment when it is totally out of funds (as

Lehman did). This will accentuate the impact on the financial system and increase the shock over that of an earlier resolution.

Further, there is a culture associated with the bankruptcy process; it is long, slow and sometimes interminable. Its principal virtue (for the Bar) is that it enables law firms to profit to a sometimes obscene degree.

(b) The Absence of Liquidity. OLA has a mechanism for supplying liquidity to a troubled bank: the FDIC provides funds at the same time it replaces the old management in a receivership. Many bank crises are essentially liquidity crises (particularly in the case of large banks), rather than true instances of insolvency (even Lehman can be debated in this regard). In contrast, bankruptcy does not offer any feasible means of providing liquidity (with the exception of debtor in possession financing). The draftsmen of the CHOICE Act apparently believe that, after a bankruptcy filing, the sound assets of the bank would be transferred to a "bridge company" (the "good bank") and the weak assets and liabilities would be left in the "bad bank." Then, the "good bank" could obtain financing in the private market without federal assistance. At best, this would take time, and, if a large bank shut down for even a few months because of a lack of liquidity, the impact could collapse the economy. At worst, this assumption that the "good bank" could obtain financing without a significant delay resembles a fairy tale.

Thus, my first "simple lesson" for a complex world is that successful reorganizations require the provision of at least short-term liquidity, and the CHOICE Act provides none. To keep a company operating and meeting its payroll requires that funds be provided at the outset.

(c) Lack of Accountability Provisions. Dodd-Frank contains multiple provisions to hold the officers and directors of a failed bank accountable. The CHOICE Act has none. This may be based on the premise that, if strict accountability provisions were authorized, no bank's management would ever file for bankruptcy, even if they knew they were hopelessly insolvent. Nonetheless, I am confident that the vast majority of Americans want accountability provisions that apply to reckless behavior by bank officers and directors that results in insolvency. By analogy, the CHOICE Act would absolve a Bernie

Madoff (if he were running a bank) in order to encourage him to file bankruptcy. That is insufficient; more is needed.

(d) Bottom Line. Although I recognize that a robust bankruptcy code provision could supply a useful alternative to OLA, it is rash to remove the safety net that OLA affords without a proven alternative. The British Financial Conduct Authority has already publically warned that if OLA is eliminated, it will have substantially less confidence in the safety and soundness of U.S. banks. More generally, bankruptcy is primarily concerned with the protection of creditors; OLA is primarily concerned with the protection of the economy and the American public from a devastating systemic risk crisis. The CHOICE Act subordinates this latter goal (saving the economy) to the former (providing full value to creditors). That is a wrong CHOICE.

II. The Off Ramp.

The CHOICE Act creates an "off-ramp" that permits financial institutions to escape Dodd-Frank's capital and liquidity requirements (and its activity restrictions) if they can satisfy a simple leverage ratio. Admittedly, that leverage ratio is demanding (10%—or well above the Basel III standard). Not all banks will be able to meet this standard, and, I concede, there are some virtues associated with a simpler standard.

But there are also two major problems associated with this "off ramp" strategy:

First, banks will be incentivized by it to shift towards a riskier portfolio of assets. That is, at any leverage ratio, banks can hold conservative assets (a portfolio of U.S. Treasury securities, for example) or risky securities (the junior tranche of a portfolio of real estate backed, sub-prime mortgage investments). In contrast, Basel III focuses on a risk-weighted leverage ratio.

Second, the CHOICE Act invites gaming by banks—in particular because the Act measures its leverage ratio only on the last day of each quarter. Those with a memory that goes back before 2008 will remember that Lehman engaged on the last day of each quarter in elaborate, multi-billion dollar derivative

transactions in order to manipulate its leverage ratio as of the last of each quarter (and then returned to its normal, more leveraged state the next day). If Congress does not learn from this history, it is destined to repeat it.

At this point, let me advance my second "simple truth": Banks can change their portfolios virtually overnight. They can move from safe assets to risky assets, or vice versa, and they will predictably play a game of regulatory arbitrage if they can escape Dodd-Frank by modifying a single metric.

Bottom Line: No single metric—leverage, capital, risky activities—is sufficient to preserve the safety and soundness of banks that are "too big to fail."

III. The Volcker Rule

Title IX of the CHOICE Act (and Section 901) repeals the Volcker Rule, which prohibits banks from engaging in proprietary trading or owning or sponsoring hedge funds. This is an amazing about face, which will shock the banks that have now largely disengaged from these activities. No justification is provided for this radical shift. If the banks are "too big to fail" (and many are) and if we do not wish them to be bailed out on insolvency by taxpayers, the only practical alternative is to regulate banks so that they do not fail. Risk-taking must be limited. The Volcker Rule is a reasonable means to this end. Further, because large banks have access to the Federal Reserve's discount windows, it is particularly unacceptable that they should be allowed to gamble with funds borrowed from the U.S. Treasury (and taxpayers).

IV. Restrictions on the Exchange Stabilization Fund

Section 133 of the CHOICE Act places strict limitations on the Treasury's Exchange Stabilization Fund so that it cannot lend to, or guarantee, the obligations of a nongovernment entity. In my judgment, the most plausible scenario for a financial panic in the future is that a money market fund will "break the buck" and thereby create a panic that leads to hundreds of thousands of middle-income investors racing in

panic to redeem their money market funds. This nearly happened in 2008 when the Reserve Fund did "break the buck." The crisis was averted when the Treasury used the Exchange Stabilization Fund to guarantee all money market funds. This is hardly an ideal solution, and the FSOC has suggested other solutions (which have been resisted successfully by the mutual fund industry). Still, use of the Exchange Stabilization Fund is a last resort solution that should not be denied to the Treasury. With little else adopted to avert a possible panic, it is foolish to abolish the Government's ability to utilize emergency solutions.

V. Financial Market Utilities

The Dodd-Frank Act requires most swaps to be cleared through clearinghouses. No one has challenged this reform because we all recall how the implosion of AIG's credit default swaps caused the 2008 crisis. But the creation of new clearinghouses creates a danger: one might fail. Such a clearinghouse failure would likely be even more catastrophic than the barely averted failure of AIG. Thus, it seems paradoxical that the provisions of Dodd-Frank allowing financial regulators to supervise clearinghouses (and other financial market utilities) would be repealed by the CHOICE Act. See Section 141. The result is to paint the financial system into a corner: requiring clearinghouses but making it easier for them to fail.

VI. Handcuffing the FSOC

The Financial Stability and Oversight Council ("FSOC") is downgraded by a number of CHOICE Act provisions, but none is more important than the eliminations of FSOC's ability to declare a non-bank to be a "systematically important financial institution." To date, FSOC has only used this power in a few cases, and the courts may resolve the propriety of its use of that power. This is an emergency power, and none of us can foresee what new and powerful financial institution will arise in the future. To deny FSOC that power assumes inaccurately that major changes in the financial environment will not occur in the future.

VII. Risk Retention Rules

Section 842 of the CHOICE Act would repeal Dodd-Frank's risk retention requirements (except in the case of residential mortgage securities). The simple truth that we all learned in 2008 was that the "originate to distribute" model is dangerous and encourages reckless behavior by originators who do not have to hold any percentage of their own product. The most feasible answer is to make them keep some "skin in the game." Residential mortgages are not unique; other financial assets can also be recklessly securitized, and the CHOICE Act will permit and encourage a return to such practices.

B. INVESTOR PROTECTION

The CHOICE Act does desirably increase penalty levels (see Sections 801-806), but this is more than offset by the following features:

1. The Defacto Elimination of Administrative Proceedings.

Section 823 of the CHOICE Act would enable a defendant charged civilly in a SEC administrative proceeding to require the SEC to move the proceedings to federal court. I suspect that the vast majority of such defendants would so opt—if only to slow the pace down. The SEC is severely resource constrained, and administrative proceedings permit the SEC to litigate at lower cost and more quickly. The slower the SEC must go, the more wrongdoers who escape sanctions. I do recognize that there are constitutional issues surrounding the SEC's use of administrative proceedings, but these issues do not involve questions of due process, but rather issues of executive power. They are best left to the Supreme Court to resolve in due course.

If a defendant did opt to stay in the administrative hearing, Section 831 raises the standard that the SEC must meet to "clear and convincing evidence." This is a standard usually reserved for issues involving loss of civil liberties, rather simply a monetary judgment. It adds another unnecessary obstacle to the SEC's ability to enforce the federal securities law.

2. Officer and Director Bars. Section 825 would also repeal the SEC's existing authority to bar individuals from serving as officers or directors of a public company. Although I agree that such a sanction should not be imposed indiscriminately (and might even justify a "clear and convincing" standard of proof), there is no reason to take this power away from the SEC. Can anyone doubt that a Bernie Madoff (if he escaped criminal liability) should be barred from so serving?

3. Fiduciary Duty. Section 841 of the CHOICE Act repeals the Department of Labor's fiduciary rule for brokers and other investment advisors. The SEC has shown for several years now that it is hopelessly stalemated on these issues and cannot strike a compromise between the "suitability rule" applicable to brokers and the tougher fiduciary rule applicable to investment advisers. Meanwhile, the industry has begun to respond to the DOL's rule, and major brokers are shifting from commissions to annual fees. In this light, repealing the DOL's rule and expecting the SEC to craft a substitute are ill-advised steps.

4. Enforcement Generally. The CHOICE Act adds a variety of new procedural rights and cost/benefit analyses that will hobble the SEC's enforcement program. I simply do not have the time or space to discuss all these, and I do not suggest that every one of these provisions is misguided, but the cumulative effect will be devastating.

Testimony of the Reverend Willie Gable, Jr., D. Min.

Pastor, Progressive Baptist Church, New Orleans, Louisiana

Chair, Housing and Economic Development Commission of the National Baptist Convention USA, Inc.

Before the U.S. House Committee on Financial Services

Continuation of the Hearing entitled "A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs"

April 28, 2017

Good morning to the Members of the House Committee on Financial Services. Thank you for inviting me to testify today.

I am the Reverend Willie Gable, Jr. I serve as Pastor of Progressive Baptist Church in New Orleans. My congregation is a member of the National Baptist Convention USA, Inc. the nation's largest predominantly African-American religious denomination. I also serve as Chair of the Housing and Economic Development Commission of the National Baptist Convention USA, Inc. This Commission's mission is to develop affordable housing for low and moderate-income persons, particularly for senior citizens and the disabled, allowing them to live with pride in a place they can proudly call home. Over twenty years, the Commission has developed over a thousand homes at 30 housing sites across 14 states.

The National Baptist Convention USA, Inc. is a member of two faith coalitions that work to end predatory payday lending. One is the Faith & Credit Roundtable, and interfaith coalition of which I am Co-Chair. The other is the Faith for Just Lending Coalition, a Christian Coalition where we are one of the founders and sponsoring organizations. These two coalitions worked tirelessly to submit comments to the Consumer Financial Protection Bureau (CFPB) to encourage them to issue a strong payday and car title rule. Our worked gleaned comments from national religious denominations, traditions, and ministries representing more than 118 million people of faith that believe the CFPB should issue a strong payday and car title loan rule with the ability-to-repay standard as a component. We will not have our efforts be in vein.

I am here today to discuss the devastating impact that predatory financial practices have wrought on my community and on communities across this nation. While I applaud the regulatory reforms in recent years that have made the market safer, there is much more work that needs to be done to rein in repugnant predatory financial practices and wealth

stripping toxic products that do not benefit the consumer or the economy. I look forward to our discussion of the need to ensure that all financial institutions are subjected to responsible, reasonable regulatory oversight that maintains sensible consumer protections.

I. In our discussion of Chairman Hensarling's CHOICE Act, we should not forget the lessons of the recent past. By abandoning consumer protections, we may be doomed to repeat the mistakes that lead to the Great Recession of 2008.

It is impossible to overstate the damage done to the families and communities most impacted by the worst financial crisis since the Great Depression. Over 12 million homes lost, representing families displaced, lives turned upside down, life savings washed away. Over $2.2 trillion in lost property value for communities surrounding foreclosed properties, with over half of that lost value sapped from communities of color. An entire generation of wealth building for all Americans, but particularly communities of color, is now tragically lost. The wealth gap, already a chasm, made even wider still.

In our discussion of the CHOICE Act, it is of the most upmost importance that we be reminded that this crisis was caused by unrestrained predatory mortgage lending practices and a failure to stop them. These predatory lending practices were permitted because the existing regulators, with whom consumer protection authority had been vested, failed to prohibit them. Congress gave the Federal Reserve Board rulemaking authority in 1994 to prohibit unfair and deceptive practices in the high-cost mortgage market. The Board failed to use this authority until 2008; by then, the damage had been done. The national bank and thrift regulators, the OCC and the OTS, had enforcement authority against unfair practices. But they treated their supervisee banks like clients, competing for their charters by being most willing to ignore the abusive practices that the agencies' own supervisory guidance advised against. The existing federal regulators failed, and the whole nation suffered. Some suffered far more profoundly than others.

Many continue to suffer. Full recovery will take decades, or significantly longer if we return to the days of an unregulated and unrestrained financial system that this bill would result in.

II. The Consumer Financial Protection Bureau has brought positive change and stability to the market and should not be weakened.

Luckily, post 2008 recession legislation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[1] become law to protect consumers, tax payers, and the economy at large. Out of Dodd-Frank, the Consumer Financial Protection Bureau (CFPB), a watchdog with the unique and sole purpose of protecting consumers from predatory financial actors, was created.

Under the stellar leadership of Director Cordray, the CFPB has issued and proposed rules that make the market safer for consumers and the general economy. The CFPB has issued rules and created standards, such as Qualified Mortgage (QM) rule and the ability-to-repay standard, to make the mortgage market safer. In addition to the mortgage rules, the CFPB has issued a rule to make prepaid cards safer and fairer for consumers who rely on them. The Consumer Bureau has also undertaken enforcement actions that benefit consumers by either shielding them from harm or compensating them for wrong done by illegal financial practices.

The Consumer Bureau has also simplified bank disclosures borrowers receive when taking out a loan, protected military families against illegal foreclosures and abusive student and payday loans, and has guarded seniors from predatory scams. Further, the Bureau has obtained more than a billion dollars in compensation to consumers harmed by misleading credit card add-on products from big banks, and to consumers harmed by the recently uncovered egregious fraudulent acts of Wells Fargo in opening checking accounts without customers' approval. Finally, the CFPB has also provided $160 million in settlements to consumers harmed by

[1] Public Law 111-203 (2010).

discriminatory auto interest rate mark ups where borrowers ended up with higher-cost auto loans when they qualified for more affordable loans. The Consumer Bureau hears directly from Americans harmed by illegal financial practices through its searchable public complaints database, which has helped people resolve disputes and allowed the Bureau to identify patterns in predatory industry practices. The system has recorded more than one million consumer complaints.[2]

All responsible players, including lenders and investors, stand to benefit from the environment the CFPB has and continues to create - ensuring the safety and soundness of institutions, protecting community financial institutions from unfair competition, and defending the nation's financial market from systemic risk. All stand to benefit from a stable economy marked by growth and wealth protection/building. The CHOICE Act seeks to undo much of the Dodd-Frank Act and to significantly weaken the CFPB, leaving a gaping wide window for the unrestrained predatory practices of the past to return and send us into another massive spiral of economic decline.

III. While the CFPB has made the market safer, it must be allowed to continue to work in areas, such as payday and car-title lending, that are in dire need of regulation. The CHOICE Act is dangerous to turn an intentionally blind eye to predatory lending.

Even though the economy is on a stable path to recovery and much has been done with the robust work of the Consumer Bureau, there remain areas of critical concern that must be addressed. The CFPB must be allowed to continue to do its work on behalf of consumers.

For instance, The CHOICE Act would prohibit the CFPB from regulating Payday loans and their close cousins, car title loans, which are an abomination in plain sight. These unaffordable

[2] Consumer Financial Protection Bureau, CFPB Complaint Snapshot Spotlights Money Transfer Complaints: Bureau Marks Over One Million Consumer Complaints Handled (2016), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-complaint-snapshot-spotlights-money-transfer-complaints/.

loans, which are often directly marketed to financially struggling lower wealth families, servicemembers, and communities of color, typically carry annual percentage rates (APR) of at least 300 percent. These lenders weave themselves into the fabric of our neighborhoods and purport to lend a helping hand. But they are wolves in sheep's clothing. They claim to be for a once-in-a-blue moon emergency, but three-fourths of their loan volume comes from borrowers with more than 10 loans a year. This debt trap is extremely hard to escape, typically leading to a cascade of other financial consequences, such as increased overdraft fees, delinquency on other bills, involuntary loss of bank accounts, and even bankruptcy. For unaffordable car title loans, the result is too often the repossession of a borrower's car, a critical asset for working families. Nationwide, payday and car title loans drain $8 billion in fees every year. [3] Many of these predatory payday and car title lenders use their massive profits on poverty to pad the pockets of legislators to prevent enactment of any reasonable restrictions. In my home state of Louisiana, this strategy has been sadly successful, despite widespread opposition from churches and other organizations who work directly with families these loans hurt.

In addition to the fee drains, there are wider economic consequences to unchecked and unregulated payday and car title loan products. We know that these lenders have a devastating impact on our local economies. Payday loans and lenders are an extraction industry - siphoning away our resources and leaving financial devastation to local economies in its wake. This industry must absolutely be regulated, and I oppose any legislation, including the CHOICE Act, that would allow these practices to continue unchecked.

Finally, The CHOICE Act eviscerates the CFPB's ability to fulfill its mission to protect consumers from predatory financial products and practices. The bill eliminates the CFPB's

[3] Diane Standaert and Delvin Davis, Payday and Car Title Lenders Drain $8 Billion in Fees Every Year (updated 2017), *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_statebystate_fee_drain_may2016_0.pdf.

ability to supervise and conduct examinations on most financial institutions, eliminates all market monitoring authority, and puts enormous constraints on the CFPB's rulemaking and enforcement. The Consumer agency must be equipped with the proper jurisdiction and enforcement powers in order to further rein in toxic loan products that harm many communities and local economies. The CFPB must also be able to maintain its independence from political influences and remain an independent agency with research, education, supervisory, and enforcement arms to keep consumers and the market safe. The CFPB director should remain removeable for cause (versus "at-will") to also shield its independent work from political whims. The CFPB structure and funding should remain as Congress enacted so that the Bureau may continue its work on behalf of America's consumers without gridlock and special interest pressure.

Conclusion

The CHOICE Act will lead this nation into the wrong economic direction. The CFPB has recovered nearly $12 billion for 29 million consumers who have been harmed by illegal practices of credit card companies, banks, debt collectors, mortgage companies, and others. This relief includes monetary compensation to harmed consumers, principal reductions, canceled debts, and other remedies to address these practices. However, relative to the funds predatory practices strip, this amount is quite modest. This means that the Consumer Bureau has far more work to do, and should be allowed to do so.

It is clear that a strong, well-funded, independent agency whose job it is to wake up in the morning thinking about protecting the most vulnerable among us is necessary to ensure that financial services practices do not drain hard-earned income and savings from my constituents,

and from the millions of other Americans who are affected by predatory lending every day. I implore you to let the CFPB be the consumer watchdog this body mandated that it be in the wake of the financial crisis. We have seen what happened when there was none, and the CHOICE Act would take us back to that place. We all deserve far better. Thank you again for the opportunity to testify today. I look forward to your questions.

AFR Americans for Financial Reform

STATEMENT OF
AMANDA JACKSON
ORGANIZING AND OUTREACH MANAGER
AT
AMERICANS FOR FINANCIAL REFORM

A PROJECT OF
THE LEADERSHIP CONFERENCE ON CIVIL AND HUMAN RIGHTS

HEARING ON THE
"FINANCIAL CHOICE ACT OF 2017"
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 28, 2017

Members of the Committee, thank you for the opportunity to testify today. My name is Amanda Jackson and I am the Organizing and Outreach Manager for Americans for Financial Reform. Americans for Financial Reform is a nonpartisan and nonprofit coalition working to lay the foundation for a better financial system.

The hardest part in talking about this bill is figuring out where to start, because it is such a comprehensive disaster. This legislation would be better dubbed "Wall Street's CHOICE Act," because it would have a devastating effect on the capacity of regulators to protect the public interest and defend consumers from Wall Street wrongdoing and the economy from risks created by too-big-to-fail financial institutions.

Not only does this bill eliminate numerous major elements of the Dodd-Frank protections passed in the wake of the financial crisis of 2008, it would also weaken regulatory powers that long pre-date Dodd-Frank. If this bill passed, it would make financial regulation significantly weaker than it was even in the years leading up to the 2008 crisis.

The basic story CHOICE Act proponents are telling about why this legislation is needed is a lie:

- Financial regulation is not hurting workers, consumers or the economy.
- There is no evidence that the economy is being harmed by financial regulation. In fact, lending is growing at a healthy rate. Over the past 3 years real commercial bank loan growth has averaged almost 6 percent annually, which is higher than historical average of 4 percent. It's worth noting that loans at community banks are growing even faster, with community bank loan growth exceeding that in larger banks over each of the last two years.

This is not to say that everything is great for most Americans - it is not; and in fact one of the reasons for that is the still-echoing effect of the financial crisis of 2008. The Center for Responsible Lending's

State of Lending report showed two trends: first families were already struggling to keep up before the financial crisis hit. The gap between stagnant family incomes and growing expenses was being met with rapidly increasing levels of debt. Second, the terms of the debt itself have acted as an economic weight and a trap, leaving families with less available income, pushing them further into debt traps, and causing a great deal of financial and psychological distress.

Those most impacted by the 2008 crisis -- low-to-middle income individuals and communities of color -- are still rebounding. The impact of the crisis is closer to us than we realize. Just Wednesday, my Lyft driver shared with me that he worked as an analyst for (using his words) corporate America. When the crisis hit, he lost his job. He took a couple of consulting contracts and part-time jobs, but he said his life has been in 'free-fall" and "a mess" since.

People lived this and are still reeling with its aftermath. They think -- quite sensibly -- that big banks have too much power and influence, not too little.

This legislation is crammed with deregulatory gifts that would facilitate abuses by financial institutions, including giant mega-banks who want to return to the excessive borrowing and risky practices that led to the financial crisis; private equity and hedge funds who want to manipulate the rules to enrich their executives; mortgage lenders who want to undo the safeguards against the unaffordable loans that drove the financial crisis; payday and car title lenders pushing products that trap consumers in a cycle of ever increasing debt, and more. The Wall Street's CHOICE Act would:

- Create unprecedented barriers to regulatory action that would effectively give large financial institutions power to overturn or avoid government oversight.
- Strip the powers of the Consumer Financial Protection Bureau to address abusive practices in consumer markets, returning us to the regulatory patchwork that failed before the crisis and the CFPB was created to solve.
- Eliminate critical elements of regulatory reforms passed since the crisis, including restrictions on unaffordable mortgage lending, the Volcker Rule ban on banks engaging in hedge-fund like speculation, restrictions on excessive Wall Street bonuses, and more.
- Increase the ability of "too big to fail" financial institutions to hold up the public for a bailout by threatening economic disaster if they failed.

It seems like what all that means has escaped some members of the Financial Services Committee. This legislation begs the question, do its drafters fully grasp the economic devastation unleashed by a failure to control Wall Street predation? It looks like a Returned Peace Corps Volunteer serving abroad for two years, finding out at the airport that her childhood home fell into foreclosure; It's a pastor who had to put a two-time limit on helping parishioners that have fallen victim to the debt trap of online payday lending so he could still help the next person; It is the misuse of the criminal justice system to threaten a mother of two with jail time by a debt collector; It's reflected in soulless neighborhoods full of dilapidated properties with "foreclosed" signs.

It is profoundly foolish to eliminate safeguards against the catastrophic consequences of a financial crisis. It is also wrong to place such severe restrictions on the ability of regulators to protect the public from exploitation in their everyday transactions with the financial system. We urge you to reject this radical and destructive legislation.

THE ECONOMIC PROGRAM

Testimony of Emily Liner

Senior Policy Advisor

Third Way

Before the House Financial Services Committee

April 28, 2017

Chairman Hensarling, Ranking Member Waters, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Emily Liner, and I am a senior policy advisor in the Economic Program at Third Way, a centrist think tank located in Washington, DC.

There are many reasons to support the Dodd-Frank financial reform law. The perspective I am going to take is on Dodd-Frank's positive effect on economic growth. My view and the view of Third Way—from studying this law and speaking with dozens and dozens of experts in the realm of business and finance—is that Dodd-Frank is pro-growth, pro-market, and pro-investor. That is why we at Third Way are concerned that the Financial CHOICE Act would undo the progress that Dodd-Frank has made to make the financial sector safer while still preserving its ability to innovate and allocate capital.

Let me take you through why we feel this way. Let's start with risk-weighted capital. Risk-weighted capital is one of the air bags that protects our banking system from melting down. It requires banks to maintain a sufficient level of equity based on the riskiness of its assets. Because of Dodd-Frank, risk-weighted capital in the U.S. banking sector has increased 41% since 2009.[1] That means banks are significantly safer. And thanks to the banking watchdogs at the Federal Reserve, the eight biggest U.S. banks are required to have risk-weighted capital levels above and beyond the industry standard. That keeps banks safe and sound, which is good for growth, for markets, and for investors. The CHOICE Act, however, repeals risk-weighted capital, as well as the liquidity coverage ratio. This will make banks less safe and will—at some point—cost our economy, undermine growth, and hurt investors.

What makes Dodd-Frank a pro-market law is its focus on risk that could be spread through interconnected financial institutions. Stress tests, for example, are an annual exam of the nation's largest and most important financial institutions to determine if they could survive a bad recession. It is not an easy test, nor should it be. Eventually, there will be another economic downturn, and we need to be certain that our largest financial institutions can weather the storm so that we can return to growth, we can return to strong markets, and we can prevent massive investor losses far more quickly. If we had had stress tests before the financial crisis, we could have been prepared to take action before the chain reaction of bank failures unfolded. The CHOICE Act weakens the stress test exercise by making the penalty on paying out dividends optional for banks that meet its low standard for exemption from the rules. Make no mistake, this will come back to hurt our economy.

Finally, Dodd-Frank is a pro-investor law. The Volcker Rule ensures that American

families who participate in the markets as retail investors are protected from harm. Investment bankers can still take risks, but the Volcker Rule prevents that risk from spilling over and hurting innocent people. During the financial crisis, $2.8 trillion in retirement savings evaporated.[2] We owe it to the hardworking Americans who lost the money they spent years scrimping and saving to never let this happen again. But the CHOICE Act repeals the Volcker Rule as well as other reforms that keep the financial system healthy.

The few safety and soundness standards the CHOICE ACT does include—like the 10% leverage ratio—are simply not enough alone to protect the world's largest economy. Under the CHOICE Act's regime, the leverage ratio is the only thing standing between some regulation and no regulation. No one should be comfortable with just one number determining whether banks can opt-out of the entire framework for financial safety regulation.

Dodd-Frank is a balanced law that makes banks safer. When banks are safer, we reduce the probability that a crisis will happen. That gives the economy more room to run and grow. According to a cost-benefit analysis of capital and liquidity requirements we performed at Third Way, we find that Dodd-Frank contributes $351 billion to U.S. GDP over 10 years.[3] There is a tangible economic benefit to making the financial sector more stable.

When the economy is humming along, we rarely acknowledge that regulations create a safe environment that allows the economy to expand. But when the economy blows a fuse, it is Dodd-Frank, not the Financial CHOICE Act, that will make sure recessions are short and manageable. For reasons of economic growth, healthy markets, and investor protection, Third Way opposes this legislation to repeal our strongest financial reforms and replace them with such a weak alternative.

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[1] United States, Federal Deposit Insurance Corporation, "Balance Sheet," QBP Time Series Spreadsheets, Quarterly Banking Profile, December 31, 2016. Accessed March 24, 2017. Available at: https://www.fdic.gov/bank/analytical/qbp/. Cited in "The CHOICE Act Doesn't Prevent Bailouts. Dodd-Frank Does." Third Way, Memo, April 25, 2017. Accessed April 27, 2017. Available at http://www.thirdway.org/third-way-take/the-choice-act-doesnt-prevent-bank-bailouts-dodd-frank-does.

[2] "The Cost of the Crisis," Report, Better Markets, July 20, 2015, p. 10. Accessed January 10, 2017. Available at: https://www.bettermarkets.com/costofthecrisis.

[3] "The Economic Benefit of a Stable Financial System," Third Way, Report, January 11, 2017. Accessed April 27, 2017. Available at http://www.thirdway.org/report/the-economic-benefit-of-a-stable-financial-system.

TESTIMONY OF MELANIE SENTER LUBIN

MARYLAND SECURITIES COMMISSIONER

ON BEHALF OF

THE NORTH AMERICAN SECURITIES ADMINISTRATORS

ASSOCIATION, INC.

BEFORE THE

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

"A Legislative Proposal to Create Hope and Opportunity for Investors,

Consumers, and Entrepreneurs"

April 28, 2017

WASHINGTON, DC

I. Introduction

Good morning Chairman Hensarling, Ranking Member Waters, and Members of the Committee. My name is Melanie Lubin. For the past 30 years, I have worked in the Securities Division Office of the Attorney General of Maryland, serving as an Assistant Attorney General, and, since 1998, as Maryland Securities Commissioner. I also represent Maryland within the North American Securities Administrators Association, or "NASAA," and currently serve as member of its Board of Directors and Committee on Federal Legislation. Since 2015, I have also served as NASAA's non-voting representative on the Financial Stability Oversight Council.

NASAA was organized in 1919, and its U.S. membership consists of the securities regulators in the 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

State securities regulators enforce state securities laws by investigating suspected investment fraud, and, where warranted, pursuing enforcement actions that may result in fines, restitution to investors and, in some instances, jail time. State securities regulators also ensure honest financial markets by licensing registrants—both firms and investment professionals—and conducting ongoing compliance inspections and examinations. In addition to serving as "cops on the beat," state securities regulators serve as the primary regulators of many small and local securities offerings, and are frequently in a position to assist local businesses seeking investment capital.

I am honored to testify before the Committee today about NASAA's views on a legislative proposal, introduced Wednesday, entitled the Financial CHOICE Act of 2017.

II. NASAA's Perspective on Financial Choice Act

Congress enacted the Dodd-Frank Act in July 2010, in response to the 2008 financial crisis. The purpose of the Dodd-Frank Act was to strengthen our financial system and better protect the millions of hard-working Americans who rely on their investments for a secure retirement. Passage of the Act was central to restoring Main Street investors' confidence in our capital markets. The reforms and investor protections in the law were born of necessity. Trust in the markets needed to be restored for our system of capital formation to thrive.

The Financial Choice Act neither improves nor builds upon the critical safeguards that Congress crafted in response to the financial crisis. Rather, the bill is predominantly deregulatory in nature. By eviscerating so many critically important reforms, the legislation sweeps away long overdue enhancements to our financial regulatory architecture.

State securities regulators are deeply concerned that, if enacted in its current form, the Financial Choice Act would detrimentally change regulatory policies, and expose investors and securities markets to significant, unnecessary risks.

III. Discussion of Selected Provisions

The full Written Statement NASAA submitted for this hearing (Addendum A)[1] addresses twenty three provisions in the Financial Choice Act. I am happy to discuss any of these provisions during the question and answer portion of the hearing. I would like to use the balance of my oral testimony to highlight several elements of the legislation that NASAA considers particularly problematic.

1. Coordination of Enforcement Activity

First, Section 391 of the bill includes a provision that attempts to mandate coordination among financial regulators including the states. Specifically, the provision requires federal financial regulators to implement policies to (1) minimize duplication between federal and state authorities in bringing enforcement actions; (2) determine when joint investigations and enforcement actions are appropriate; (3) and establish a lead agency for joint investigations and enforcement actions.

While the provision may appear relatively benign on its face, state regulators are deeply concerned that, if enacted, it will impose Washington's bureaucracy, red tape, and priorities at the state and regional level. Today, coordination between state and federal securities regulators is a voluntary process. This process ensures that the jurisdictional reach of the regulators remains unhindered and that harmful conduct is addressed in an efficient manner without the need to work through federal bureaucratic obstacles. Because state securities regulators prioritize the protection of retail investors, forcing states to take a back-seat during investigations that involve more than one agency would put these "mom and pop" investors more directly in harm's way.

We urge Congress to remove the reference to state authorities from Section 391.

2. Bad Actor Disqualifications

NASAA's second area of concern involves Section 827 of the bill, a baffling attempt to impose additional procedural hurdles, which would in turn hinder keeping bad actors out of the securities industry. The Dodd-Frank Act took an important step toward reducing risks for investors in private offerings by requiring the SEC to exclude bad actors from utilizing the Regulation D, Rule 506 exemption. Enacting any legislation that would needlessly expose unknowing investors to proven bad actors would be a grave mistake.

3. Capital Formation

(a) Crowdfunding

NASAA's next area of concern is Subtitle P, which would enact a wholesale revision of the Crowdfunding provisions of the JOBS Act, less than a year after they took effect. If Congress is poised to enact policies intended to strengthen the economy, this provision will have precisely

[1] NASAA's Written Statement for this hearing was submitted on April 26, 2017 by NASAA President and Minnesota Commerce Commissioner Mike Rothman for inclusion in the hearing record. This Written Statement is included in its entirety as Addendum A. (P. 5)

the opposite effect. Among other things, this provision would: eliminate individual and aggregate investment caps; allow an issuer to conduct federal crowdfunding without a registered intermediary; remove many required disclosures to investors and ongoing reporting to the SEC; and remove liability provisions that were carefully crafted to apply to the unique characteristics of a crowdfunded offering.

(b) Venture Exchanges

NASAA is also very concerned about provisions in Subtitles L and M.

Subtitle L creates a new class of security, a "venture security" that would be listed and traded on a new "venture exchange." These securities would be exempt from a significant number of regulatory requirements, including state registration requirements, and presumably subject to significantly diminished listing standards.

Subtitle M would allow the SEC to recognize any exchange – of any size or quality – as a "national securities exchange." All securities listed on these exchanges would be preempted from state registration laws. The benchmark for preemption established by Congress in existing law is that an exchange must have rigorous listing standards "substantially similar" to those of the major national stock exchanges, such as the New York Stock Exchange. Allowing an exchange to qualify as a national securities exchange regardless of the quality of the exchange or of its listed securities removes vital investor protections.

4. Fiduciary Duty

The final concern I will discuss is NASAA's opposition to Section 841. NASAA has long supported a heightened standard of care for broker-dealers. Clients expect broker-dealers to act in the client's best interest.

This provision would, among other things, invalidate the rule recently adopted by the Department of Labor establishing a heightened standard of care for retirement accounts. It would also effectively prevent the DOL from undertaking any future rulemaking regarding the conduct of broker-dealers in the management of retirement accounts until the SEC completes rulemaking. The provision would also impose on the SEC unduly onerous requirements for regulatory, analytical, and economic analysis prior to adopting a rule.

Ultimately, Section 841 would serve to delay and perhaps prevent any effort to establish a meaningful heightened standard of care for broker-dealers. Investors expect their broker-dealer to act in their best interest and Section 841 is contrary to that expectation.

IV. Conclusion:

Thank you again for the opportunity to testify before the Committee. I would be pleased to answer any questions.

ADDENDUM A

I. Introduction

Good morning Chairman Hensarling, Ranking Member Waters, and Members of the Committee. On behalf of the North American Securities Administrators Association, Inc. ("NASAA"), I am pleased to submit this statement for inclusion in the record of the April 26, 2017, hearing entitled "A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs," which will examine recently released "discussion draft" legislation entitled "The Financial CHOICE Act of 2017" ("Financial Choice Act" or "bill").

NASAA was organized in 1919, and its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. In the United States, state securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. State securities regulators are responsible for administering state securities laws that both serve to protect your constituents from fraud while also providing regulatory frameworks through which businesses can raise capital.

State securities regulators enforce state securities laws by investigating suspected investment fraud, and, where warranted, pursuing enforcement actions that may result in fines, restitution to investors and, in some instances, jail time. Keeping the bad actors out of the markets serves not only the interests of investors, but the businesses that rely on markets to raise money. State securities regulators also ensure honest financial markets by licensing registrants—both firms and investment professionals—and conducting ongoing compliance inspections and examinations.

In addition to serving as "cops on the beat," state securities regulators serve as the primary regulators of many small and local securities offerings. As such, state securities regulators regularly provide important information to local businesses seeking investment capital. Moreover, state securities regulators, acting within NASAA, have a long history of working closely with the U.S. Securities and Exchange Commission ("SEC" or "Commission") to effect greater uniformity in federal-state securities matters.

Finally, both independently and within the framework of NASAA, state securities regulators have consistently provided Congress and other federal policymakers with timely, pertinent information, gleaned from our experiences, which may be relevant to federal policymaking activities. During the approximately two years between the onset of the Financial Crisis in August 2008, and the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") in July 2010, NASAA provided extensive commentary to Congress on financial regulatory reform legislation, including through testimony and more than a dozen letters addressing legislative proposals under the jurisdiction of the Financial Services Committee. Further, in January 2010, NASAA delivered detailed testimony to the U.S. Financial Crisis Inquiry Commission regarding the perspective of state securities regulators on the Crisis, and since 2011, NASAA's membership and staff have actively participated in the activities of the Financial Stability Oversight Council ("FSOC"), as well as several federal advisory committees and similar working groups.

II. NASAA's Perspective on the Financial Choice Act of 2017

Congress enacted the Dodd-Frank Act in July 2010, in response to the financial crisis of 2008-2009, to strengthen our financial system and better protect the millions of hard-working Americans who rely on their investments for a secure retirement. The Dodd-Frank Act was crafted to promote stronger

investor protection and provide more effective oversight to help prevent another economic crisis. Passage of the Act was central to the restoration of the confidence of Main Street investors in our capital markets. In addition to provisions designed to strengthen our financial system, the Dodd-Frank Act addressed a number of critical issues affecting retail investors, such as incorporating disqualification provisions to prevent securities law violators from conducting securities offerings under SEC Regulation D, Rule 506; strengthening the accredited investor standard; increasing state regulatory oversight of investment advisers; providing for a means to enact a fiduciary duty for broker-dealers; providing authority to prohibit or limit the use of mandatory pre-dispute arbitration contracts by broker-dealers in customer agreements, among many other important reforms.

The reforms and investor protection provisions in the Dodd-Frank Act were born of necessity: trust in the market needed to be restored if our system of capital formation was to thrive. The financial crisis had underscored that the existing securities regulatory landscape required an overhaul. By passing the Dodd-Frank legislation into law, Congress signaled the beginning of a new era of financial market oversight and investor protection, including reforms intended to better empower state securities regulators to protect citizens from fraud and abuse.

As is true of any major legislation, the Dodd-Frank Act requires improvements and updates; however, the Financial Choice Act does not improve nor build upon the modernized financial regulatory framework that Congress crafted in response to the lessons of and weaknesses exposed by the Financial Crisis. Rather, the bill is predominantly backward-looking and deregulatory in nature. By attempting to eviscerate so many of the critically important reforms summarized above—weakening oversight of private securities markets and reforms; watering down provisions intended to expand fiduciary obligations to investment professionals; lowering standards for securities sold to the investing public; diluting rules that keep "bad actors" out of our securities markets, among many others—the legislation blithely aims to sweep away in one stroke scores of essential protections and modernizations to our financial regulatory architecture that were literally decades in the making.

In sum, state securities regulators are deeply concerned that, if enacted in its current form, the Financial Choice Act would dramatically change regulatory policies in the wrong direction, weakening the important reforms and protections put in place in response to the financial crisis, and exposing investors and the securities markets to significant, unnecessary and new risks.

III. Provisions Affecting Investors and Securities Markets

The legislation and policy changes embodied in the Financial Choice Act are far too vast to address comprehensively in my statement today. Indeed, so numerous and extensive are the revisions contemplated by the bill that I will not be able to fully or comprehensively address even those of the bill's provisions that are of direct interest to NASAA and state securities regulators. I will use the remainder of this statement to highlight for the Committee several provisions that NASAA considers to be of utmost interest and importance, and to furnish some analysis of the impact of the provisions. In certain cases, where NASAA has previously commented on a particular provision, I will simply note this fact in my statement and provide appropriate citations so that the Committee may easily access the relevant commentary for the record.

A. Provisions Relating to Enforcement & Regulatory Authority

The Financial Choice Act would make it more difficult for state securities regulators and other regulatory and law enforcement agencies to police U.S. securities and other financial markets to protect investors from fraudulent and abusive practices. NASAA appreciates that the bill does include some provisions that stand to enhance the ability of the SEC to impose meaningful civil penalties for certain

violations of securities laws. However, when viewed in their totality, it is clearly evident that the changes contemplated by the bill would significantly undermine and compromise regulators' ability to effectively enforce financial laws and regulations.

Section 391. Joint Investigations and Enforcement Actions

Section 391 is overbroad and misguided in including State authorities as part of efforts to minimize duplication of enforcement efforts; therefore, the reference to "State authorities" should be removed. Section 391 seeks to require federal agencies, including the SEC, to implement policies to (1) minimize duplication between federal and state authorities in bringing enforcement actions; (2) determine when joint investigations and enforcement actions are appropriate; and (3) designate a process to establish a lead agency for joint investigations and enforcement actions. Section 391's reference to "State authorities" is both unnecessary in light of the existing voluntary collaboration, described below, as well as wholly unworkable because of Supreme Court case law that delineates state and federal authority in law enforcement.

In the realm of securities regulation, state and federal securities regulators currently collaborate on a voluntary basis, usually at the regional level, with common goals of sharing information and leveraging resources efficiently. Collaboration includes ongoing informal quarterly or monthly meetings at the state or regional levels; regulators working on investigations and enforcement cases when the nature of the case or warrants collaboration;[2] and other initiatives, such as Memorandums of Understanding ("MOUs"). Recently, in conjunction with new rules to facilitate intrastate crowdfunding offerings and regional offerings taking effect, the SEC and NASAA signed an information-sharing MOU.[3] The agreement is intended to facilitate the sharing of information to ensure that the new exemptions are indeed serving their intended purposes of facilitating access to capital for small businesses. Such collaborative efforts are long-standing. For example, from 2011 to 2013, the SEC and state securities regulators worked closely to facilitate and streamline the process by which 2,100 investment advisers transitioned, pursuant to the Dodd-Frank Act, from federal to state oversight.[4]

This current system of voluntary collaboration ensures that resources are focused on productive collaboration, rather than working through federal bureaucratic processes and red-tape before the actual work can begin. Furthermore, voluntary collaboration can be based on the needs of a situation and take geography into account. Not every state has a federal securities regulatory presence, but every state has a state securities regulator, ensuring a boots-on-the-ground approach wherever a bad actor may be perpetrating fraud. Voluntary collaboration ensures that the jurisdictional reach of federal and state securities regulators remains unhindered and that harmful conduct is addressed in a direct and efficient manner without the need to work through federal bureaucratic obstacles.

NASAA has great concerns about hampering this voluntary state-federal collaborative framework through Section 391 as written, which could result in the SEC's Washington bureaucracy being imposed at the state and regional level. In addition to being inefficient, Section 391's inclusion of "State authorities" is opposite to the Supreme Court's holding in *Printz v. United States*, which upholds the separation between federal and state authority. Specifically, in *Printz*, the Court held that the federal government could not

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[2] This type of collaboration generally requires formalizing the relationship through access letters and other joint memoranda.

[3] *See* "SEC, NASAA Sign Info-Sharing Agreement for Crowdfunding and Other Offerings." Press Release. Feb. 17, 2017, *Available at* https://www.sec.gov/news/pressrelease/2017-50.html.

[4] For additional information see NASAA report entitled "A Successful Collaboration to Enhance Investor Protection," *Available at* http://www.nasaa.org/23169/ia-switch-report/.

compel state law enforcement offices to participate in a federal handgun regulation program.[5] Therefore, the SEC would be unable to impose its policies and procedures on state securities regulators. The current voluntary collaboration between state and federal securities regulators is far preferable to applying Section 391 to state securities regulators. Striking references to "State authorities" is necessary to improve Section 391.

Section 827. Elimination of Automatic Disqualifications

Section 827 should be stricken because it would undo important investor protection reforms. Section 926 of the Dodd-Frank Act took a necessary first step toward reducing risks for investors in private offerings by requiring the SEC to issue rulemaking to exclude bad actors from utilizing the Regulation D, Rule 506 exemption ("Rule 506"). These unregistered private offerings naturally have become a favorite vehicle for unscrupulous promoters, who use the Rule 506 exemption to fly under the radar. As required by the Dodd-Frank Act, the SEC in 2013 adopted rules prohibiting bad actors from relying on the Rule 506 exemption.[6]

In contrast to the sound policy of Dodd-Frank Section 926, the Financial Choice Act's Section 827 is baffling and misguided in its attempt to prohibit the SEC from automatically disqualifying from registration or from using a registration exemption bad actors; namely, a universe of persons the bill expressly defines to include persons "having been convicted of any felony or misdemeanor or made the subject of any judicial or administrative order…[or]…having been suspended or expelled from membership in, or suspended or barred from association with a member of a registered national securities exchange."[7] The effect of this provision would be to undermine the "bad-actor" disqualifications currently applicable to Rule 506 and other securities offerings.

This provision runs contrary to sound public policy and plain common sense. If enacted, this provision would create procedural burdens to necessary disqualifications, allowing bad actors to continue to rely on exemptions, registrations, and activities that led to those bad acts.

There is simply no valid basis for tying the hands of the SEC or any other securities law-enforcement agency in the manner contemplated by this provision.

Section 823. Private Parties Authorized to Compel the SEC to Seek Sanctions by Filing Civil Action

Section 823 was introduced in the 114th Congress as H.R. 3798, the Due Process Restoration Act of 2015. As NASAA commented previously,[8] this provision seeks to broadly undermine the efficacy of the federal securities law enforcement framework by providing all respondents in SEC enforcement cases with the right to have their case removed out of the SEC's administrative authority to a federal district court and. The right to remove would apply not only to unregulated respondents, but to entities directly regulated by the SEC, such as brokerage firms, investment advisers, investment companies, and persons associated with such entities. The provision would create a similar right of removal for persons who are subject to an

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[5] *Printz v. United States*, 521 U.S. 898, 935 (1997).

[6] *See* Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, SEC Release No. 33-9414, 78 Fed. Reg. 44729 (July 24, 2013).

[7] Sec. 827 (P. 448).

[8] *See* Letter from Judith Shaw, Maine Securities Administrator and NASAA President, to the Hon. Jeb Hensarling, Chairman, House Committee on Financial Services and the Hon. Maxine Waters, Ranking Member, House Committee on Financial Services, dated Mar. 2, 2016 *available at* nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/NASAA-Letter-Re-3-2-16-HFSC-FC-Markup-March-2-2016.pdf.

SEC cease and desist order. Finally, for cases that remain within the purview of an SEC Administrative Law Judge, the provision would raise the burden of proof from the "preponderance of the evidence" standard to a higher bar at the "clear and convincing evidence" level.[9]

The SEC has possessed the authority to seek civil monetary penalties in enforcement actions since Congress enacted the Securities Remedies and Penny Stock Reform Act of 1990.[10] In 2010, as part of the Dodd-Frank Act, Congress granted the SEC broader authority to impose civil monetary penalties in administrative proceedings. Section 929P of Dodd-Frank, amended Section 8A of the Securities Act, Section 21B(a) of the Securities Exchange Act, Section 9(d)(1) of the Investment Company Act, and Section 203(i)(1) of the Investment Advisers Act to permit the imposition of civil monetary penalties in administrative proceedings, in addition to the cease-and-desist orders previously available to the SEC.

The authority to pursue remedies for alleged violations of federal securities laws in an administrative proceeding is an important tool in the SEC's arsenal and furthers the agency's mission to protect investors. The likely impact of Section 823 on the SEC's ability to effectively police wrongdoing would be significant and would likely not only reduce the overall number of enforcement actions pursued by the SEC but the deterrent effect that comes with an effective enforcement program. Further, because SEC enforcement actions brought as administrative proceedings often conclude more rapidly than those brought in federal district court, and because they consume fewer federal resources than enforcement actions brought in the federal courts, the bill would serve to make future SEC enforcement actions significantly costlier to the SEC and the government.

Again, there is no valid basis for tying the hands of the SEC or any other securities law enforcement agency in the manner contemplated by this provision.

Section 820. Advisory Committee on Commission's Enforcement Policies and Practices

NASAA is troubled by Section 820 of the bill, which provides for the establishment of an "advisory committee on the Commission's enforcement policies and practices." State securities regulators know first-hand the importance of strong enforcement programs free of influence from the regulated entities subject to their oversight. As envisioned by the bill, the Advisory Committee would conduct analysis and make recommendations on the Commission's policies and practices, which will include direction regarding the appropriate blend of regulation, publicity, and formal enforcement actions, criteria for the selection and disposition of actions, and the suitability and effectiveness of sanctions imposed by Commission proceedings. This Advisory Committee would include up to seven members, including a Chair, each designated by the SEC Chairman.

As proposed, this new Advisory Committee has the potential to hinder and unduly limit the Commission's ability to investigate and pursue securities fraud and other misconduct. It would compromise the independence of the Commission's staff and could, over time, serve to institutionalize a degree of "regulatory capture" through the appointment to the Committee of members with perspectives and allegiances that do not fully align with the mandate of the SEC.

Subtitle A—SEC Penalties Modernization

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[9] The SEC has traditionally applied a "preponderance of the evidence" standard to administrative enforcement actions.
[10] Initially, the SEC's authority to seek such penalties in administrative proceeding was limited to regulated entities or persons associated with a regulated entity—brokerage firms, investment advisers and investment companies. In order to obtain monetary penalties against other persons, the SEC was required to pursue a civil action in federal district court.

Federal securities laws limit the amount of civil penalties that the SEC can impose on an institution or individual. NASAA supports provisions included in the Financial Choice Act that would update and strengthen the SEC's authority to impose civil penalties for securities law violations, including by directly linking such penalties to the scope of harm and associated investor losses, increasing the statutory limits on monetary penalties, and increasing the cap for repeat securities law violators.

Subtitle R—Senior Safe

Subtitle R is comprised of bipartisan legislation introduced and passed by the House during 114th Congress as the Senior$afe Act.[11] The Senior$afe Act consists of several essential features that improve protections for persons aged 65 and older from financial exploitation by increasing the likelihood it will be identified by financial services professionals and reported to state securities regulators and other appropriate governmental authorities who can help stop it. Specifically, the Senior$afe Act promotes and encourages financial services professionals, who are positioned to identify and report "red flags" of potential exploitation, to report suspected elder financial exploitation. The provision would incentivize financial services employees to report any suspected exploitation by making them immune from any civil or administrative liability arising from such a report, provided that they exercised due care, and that they make these reports in good faith. Second, in order to better assure that financial services employees have the knowledge and training they require to identify "red flags" associated with financial exploitation, the bill would require that, as a condition of receiving immunity, financial institutions train certain personnel regarding the identification and reporting of senior financial exploitation.

NASAA has supported the Senior$afe Act since its introduction in 2015, and we continue to strongly support its passage.

B. Provisions Relating to Capital Formation

The Financial Choice Act incorporates more than a dozen distinct legislative proposals pertaining to capital formation, including numerous proposals that resemble legislation considered by the Committee earlier this year and during the 114th and 113th Congress. NASAA has commented extensively on many of these past proposals, so I will focus my statement on what we view as some of the more significant proposals. However, to the extent that NASAA has previously commented on a proposal that is not addressed in my statement, I would strongly encourage interested members of the Committee to review the relevant information, as it appears on NASAA's website and in the Committee's own records.[12]

Subtitle N—Private Placement Improvement

The Private Placement Improvement provision in Section 466 of the bill would prohibit the SEC from adopting proposed rules to implement common sense reforms for Regulation D, Rule 506 offerings. As NASAA has testified on several prior occasions, state securities regulators oppose any action by Congress to further diminish the ability of the SEC to address investor protection concerns associated with these offerings or gather quantitative and qualitative data in the private marketplace.

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[11] The Senior Safe Act of 2016 (H.R. 4538) passed the House of Representatives by voice vote on July 05, 2016. (H. Rept. 114-659).

[12] NASAA testified to the House Financial Services Committee and its subcommittees regarding legislative proposals aimed at facilitating capital formation on three occasions during the 113th and 114th Congress, including on April 14, 2016, May 1, 2014, and October 23, 2013. During the same period, NASAA submitted numerous statements and comment letters addressing legislation relating to "capital formation" under consideration by the Committee. Copies of all such testimony, statements, and comment letters may be accessed on NASAA's website at nasaa.org.

Title II of the Jumpstart Our Business Startups Act of 2012 ("JOBS Act") repealed the long-established prohibition on general solicitation and advertising of securities offered under Rule 506. When the SEC adopted rules to implement Title II, on July 10, 2013, it also voted to propose rules that could improve the transparency and mitigate the risk to ordinary investors who participate in Rule 506 offerings, including a requirement to pre-file the "Form D" notice when issuers intend to advertise such offerings to the general public. The SEC's proposal would also impose meaningful penalties on issuers who fail to file a Form D.[13] Section 466 would effectively prohibit the Commission from adopting these modest proposals.

Proponents have opposed a Form D filing requirement prior to conducting a Rule 506 offering, and again upon the completion of the offering, arguing that multiple filings would impose an onerous compliance burden. Form D, however, is a short form, capturing basic information about the issuer (e.g., business address, officers, directors, business type, etc.). The amount of information required on the Form D relative to the information contained in an issuer's private placement memorandum or offering document is minimal yet vital to regulators and potential investors. These additional, modest filing requirements are particularly important in understanding the $1 trillion market in unregistered Regulation D, Rule 506 securities.

State securities regulators, pursuant to their antifraud authority, are the de facto primary regulators of offerings conducted under Regulation D, Rule 506. Fraudulent offerings involving Rule 506 offerings are routinely among the most frequently reported by state securities regulators. We believe it would be a mistake for Congress to weaken the few existing investor protections in Rule 506, and we urge the Committee to reject Subtitle N.

Subtitle L—Main Street Growth

The Main Street Growth provision would amend the Securities Exchange Act to provide a framework for a national securities exchange to elect to be treated as a "venture exchange," which the bill would define as a "market place or facilities for bringing together purchasers and sellers of venture securities." The venture exchange, as currently envisioned, would function in parallel with traditional public markets for companies under $2 billion in value. The bill would also create a new class of security—a venture security—that would be listed and traded only on venture exchanges. These venture securities would be exempt from a significant number of regulatory requirements, and presumably subject to significantly diminished listing standards.[14]

The securities listed on the venture exchange could include securities not presently listed on a national exchange, and transacted only on an over-the-counter ("OTC") basis, as well as securities listed on a national securities exchange as an "emerging growth company." One of the most notable common features of these types of securities, however, is that they are prone to illiquidity. To manufacture additional liquidity for such securities, this provision would exempt them when listed on a venture exchange from various reporting and disclosure requirements, and would establish new trading rules specifically for securities on venture exchanges, including rules that would allow higher tic-sizes.

NASAA has previously questioned the need for new legislation to establish a new venture exchange.[15] Current law allows for the creation of new exchanges, including exchanges targeted to smaller

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[13] Amendments to Regulation D, Form D and Rule 156, SEC Release Nos. 33-9416, 34-69960, IC-30595. 78 Fed. Reg. 44806. (2013, July 24). Retrieved from gpo.gov/fdsys/pkg/FR-2013-07-24/html/2013-16884.htm.

[14] Under Subtitle L, securities listed on a venture exchange would be exempt from SEC Regulations ATS and NMS, Decimalization, Sarbanes-Oxley, and State Blue Sky laws.

[15] *See* Written Statement of William Beatty, NASAA President and Washington Securities Division Director, delivered to the Subcommittee on Securities, Insurance and Investment of the Senate Committee on Banking, Housing

companies. Today, there are many national exchanges registered with the SEC that operate with varied listing requirements. In addition to traditional national exchanges, various alternative marketplaces exist, such as the OTCQX, OTCQB, and OTC Pink. It is not clear why, or if, new legislation or regulatory relief would be necessary to foster the creation of such an exchange in light of existing exchanges.

Further, it is far from certain that any venture exchange will be created, or succeed, with the enactment of this provision. Venture exchanges have existed in the past and have fared poorly. Over the past 80 years, more than 20 regional stock exchanges have gone out of business or merged with other exchanges to stay afloat. While state securities regulators do not oppose the establishment of a new venture exchange provided there are sufficient safeguards for investors, serious questions remain about the challenges to making such exchanges a successful proposition in the United States. Moreover, to the extent any securities traded on such an exchange would receive federal covered status, the exchange must have rigorous listing standards to provide protections ordinarily afforded under state Blue Sky laws.

To the extent Congress proceeds with legislation that would prescribe the establishment and structure of a U.S. venture exchange, NASAA recommends that Congress proceed in a manner that allows for adequate attention to several critical and specific considerations, summarized below.[16]

First, retail investors will be a primary source of capital for a venture exchange, which immediately raises investor protection concerns. A venture exchange likely will significantly rely on retail investors, including passive and "self-directed" retail investors, to support a market for the securities traded on the exchange, because many institutional investors simply do not invest in smaller and more speculative issues such as those that would likely be listed on a venture exchange.[17] Indeed, while it is unclear how venture exchanges would augment the many tools already available to provide capital to businesses, it is readily evident that establishing such exchanges could pose significant risks to investors. The central features of the proposed venture exchange—newer, untested companies, reduced disclosure, limited liquidity, and comparatively high rates of failure or bankruptcy and investment loss—sharply contrast with the robust disclosure and transparency regime that define America's modern and efficient capital markets.

Second, appropriate listing standards will be essential to a successful venture exchange. To be successful, a U.S. venture exchange will need to attract and sustain interest from issuers, retail investors, brokers, analysts, and other market participants, as well as some institutional capital. Sustained interest will require robust listing and disclosure standards to facilitate brokers recommending investments in securities traded on a venture exchange. When recommending investments to retail clients, brokers rely on disclosures to meet their suitability responsibilities. A venture exchange without reliable disclosure and governance requirements will face additional challenges as brokers could be unable to meet their suitability responsibilities to their clients. Similarly, inadequate listing standards will impose a major barrier to

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and Urban Affairs, "Venture Exchanges and Small-Cap Companies," Mar. 10, 2015, *available at* www.nasaa.org/34863/venture-exchanges-and-small-cap-companies.

[16] Unfortunately, only one hearing on the topic of venture exchanges has been held by the House Financial Services Committee in recent years—a subcommittee hearing in early 2015—and that hearing focused on a number of bills, one of which related to a venture exchange. The Committee needs to further explore the many challenges to establishing a venture exchange. While additional study could be helpful and even decisive in assuring the long-term prospects of a venture exchange effort, the Committee is advancing a concept that has not been fully analyzed and explored.

[17] There may be a variety of reasons that institutional investors tend not to invest in smaller issues such as those likely to be listed on a venture exchange. Some obstacles, such as potential illiquidity and lack of research coverage, may be attenuated by a venture exchange with robust listing standards. Other obstacles seem likely to persist, particularly as they relate to the size of the issues themselves. For example, the low market capitalization of the issues listed on a venture exchange may make it difficult for institutional investors to invest in them profitably, or to buy them in the ordinary course of their business activities without pushing the stock price up appreciably.

investments of assets from individual retirement accounts ("IRAs") and other tax-deferred retirement accounts, which may become subject to the fiduciary standard later this year.

In NASAA's view, among the flaws of this provision is a lack of listing standards. At the very least, the legislation must be amended to require listing standards governing reporting, auditing, accounting, due diligence, management, and corporate governance. As a general principle, the listing standards of a successful venture exchange should be as rigorous as possible without compromising the ability of the exchange to scale its requirements to reasonably reduce costs and attract listings. In addition, there should be a mechanism to remove companies that fall below the listing standards.[18] Finding the appropriate balance is challenging but absolutely crucial in establishing a venture exchange.

In any effort to develop legislation to establish a new venture exchange, Congress should account for the lessons learned from other venture exchange efforts in the United States and elsewhere. There is theoretical potential for a venture exchange to play a useful function in our capital markets, but there are also many valid questions about why, how, and whether such exchanges might succeed in the United States. Congress should study these questions more closely prior to passing legislation establishing such an exchange. In particular, Congress should examine reasons for the demise of the American Stock Exchange Emerging Company Marketplace ("ECM"), as well as the lessons learned from NASDAQ's efforts to establish a new venture exchange in 2011. Congress also should examine the international experience with venture exchanges, including notably Canada's TSX Venture Exchange, and the Alternative Investment Market ("AIM") in the United Kingdom. As former SEC Commissioner Luis Aguilar has noted, there is considerable evidence that these and other international venture exchanges are continuously plagued by low liquidity, and at times high volatility.[19] In NASAA's view, Congress should strive to understand the underlying causes of such problems prior to establishing similar exchanges in the United States.

Finally, and perhaps most importantly, venture exchanges have the potential to be very risky for certain investors. No matter how effective the regulatory scheme for a venture exchange, securities that trade on such proposed exchanges will be significantly riskier investments than securities issued by public companies traded on a major national exchange. Congress should thoroughly examine all issues NASAA and other commenters have raised regarding venture exchanges prior to advancing this or any similar legislation.

Subtitle S—National Securities Exchange Regulatory Parity

The National Securities Exchange Regulatory Parity provision would amend Section 18 of the Securities Act of 1933 to allow the SEC to recognize any exchange of any size or quality as a "national securities exchange." All securities listed on such exchanges would be covered securities and not subject to state registration laws.

NASAA strongly opposes this proposal, which threatens the core tenets of modern securities market regulation. Under existing law, a listing on a national securities exchange affords such securities

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[18] Shell or non-operating companies, for example, are often a mechanism for fraud. Indeed, since 2012, the SEC has suspended trading of more than 800 microcap stocks. Press Release, SEC, SEC Suspends Trading in 128 Dormant Shell Companies to Put Them Out of Reach of Microcap Fraudsters (March 2, 2015), available at https://www.sec.gov/news/pressrelease/2015-44.html.

[19] Remarks of Commissioner Luis Aguilar, Meeting of the SEC Advisory Committee on Small and Emerging Companies, Mar. 4, 2015, *available at* sec.gov/news/statement/need-for-greater-secondary-market-liquidity-for-small-businesses.html.

covered security status such that state registration requirements are preempted.[20] A balance was struck regarding the level of rigorousness in listing standards that would afford such covered security status and preemption of state law in 1996, with the enactment of the National Securities Markets Improvement Act ("NSMIA"). The benchmark for preemption established by Congress under NSMIA is that an exchange must have rigorous listing standards comparable to those of the major national stock exchanges, such as the New York Stock Exchange ("NYSE"), or have "substantially similar" listing standards, as the SEC may determine by rule. The rationale is that investors purchasing securities listed on an exchange that has sufficiently rigorous listing standards do not require the added protection afforded by Blue Sky registration.[21] This bill would upend the balance struck in NSMIA and remove vital investor protections afforded by state securities laws that would otherwise be applicable.

Given the number and variety of exchanges currently in existence, it is not clear why this provision is necessary.[22] Further, current law allows the creation of exchanges with varied listing requirements, including alternative marketplaces.[23] By removing the statutory references to recognized national securities exchanges like the NYSE, and the attendant requirement that all national securities exchanges with covered security status maintain meaningful listing standards that are substantially similar to such major exchanges, this language undercuts the distinction between national exchanges with rigorous listing standards and all other exchanges, including local or regional exchanges with no regard to the applicable listing standards. It also creates confusion with alternative trading systems, a secondary trading platform.[24] Ultimately, this provision will create adverse marketplace confusion and impact the quality of securities listed on recognized national exchanges.

Subtitle M—Micro-Offering Safe Harbor

The Micro-Offering Safe Harbor provision seeks to amend Section 4 of the Securities Act to create a new exemption from registration for an offering that meets the following three criteria: (1) each purchaser has a substantive pre-existing relationship with an officer or director of the issuer, or with a shareholder holding 10 percent or more of the issuer's shares; (2) there are no more than 35 purchasers of securities from the issuer in reliance on this exemption during the preceding 12 months; and (3) the aggregate amount raised by the issuer during the 12-month period preceding the transaction, including in reliance on this exemption, does not exceed $500,000. The bill also preempts state regulation of these proposed securities offerings, and does not prohibit general solicitation, disqualify bad-actors, limit offering amounts (for instance, to unaccredited investors), or permit any notice filings to state and federal regulators.

This new exemption would create an overly broad federal exemption that would allow public solicitation and sales to any investor regardless of sophistication or financial wherewithal, subject only to the requirement that there be a previously existing relationship—a standard that is not difficult to establish. We also question why an issuer would need to engage in public solicitation if it had a previously existing relationship. Further, the practical necessity of the proposed exemption remains unclear—just as basic questions about what issuers it would serve remain unanswered. In fact, there are already several provisions

[20] Exchanges with less stringent listing standards (e.g., the Miami International Securities Exchange) do not provide "covered" status.

[21] *See* Section 18(b)(1)(A)-(B)) of the Securities Act of 1933 and Rule 146.

[22] There are currently 19 national securities exchanges registered with the SEC, and ten recently approved securities exchange applications. *See* sec.gov/divisions/marketreg/mrexchanges.shtml.

[23] Various alternative marketplaces currently exist, such as the OTCQX, OTCQB, and OTC Pink. In fact, OTC Markets refers to the OTCQB as "The Venture Marketplace."

[24] If an entity is conducting secondary trading and meets the criteria of a national securities exchange, they must register under Section 6 of the Securities Exchange Act of 1934. An entity that does not meet the criteria of a national securities exchange, depending on their activities and trading volume, may alternatively register as a broker-dealer and comply with Regulation ATS.

at the state and federal level that small, microcap issuers can rely upon for limited offerings.[25] Congress should consider the relationship between this new proposed exemption and the popular, existing exemption—Rule 506(b)—that allows an issuer to sell its securities to up to 35 non-accredited, sophisticated, investors.[26]

This proposed exemption would preempt state authority to register or review securities offering that are by their nature local, state-based offerings. Without effective regulatory oversight, provisions such as this one will not succeed. Preemption of state review and registration for this type of small localized offering would serve only to handcuff the very regulators best positioned to oversee these smaller, local offerings. In short, there is no valid public policy basis for Congress to prevent state officials and their constituents from making decisions about the purely local or regional issuers that would likely rely on this provision.

Subtitle P—Fix Crowdfunding

Subtitle P of the Financial Choice Act would enact a wholesale revision of Title III of the 2012 JOBS Act, which took effect less than a year ago, on May 16, 2016. State securities regulators appreciate Congress's continued interest in federal crowdfunding but believe that Congress should wait until the framework has matured and there is a sufficient record in place before making changes to the crowdfunding law. This is particularly important given the significant overhaul contemplated in this section of the Financial Choice Act.

It is still too early to determine what changes are needed to improve or "fix" federal crowdfunding as there is limited available data. Moreover, enacting a wholesale replacement of federal crowdfunding runs contrary to the work entailed by Congress in drafting Title III of the JOBS Act, and extensive SEC rulemaking to implement Title III. The final federal crowdfunding provisions represent a balance struck by Congress to encourage small business capital formation while also protecting investors.

State securities regulators agree that small businesses are important to job growth and to the continued improvement of the overall economy. In fact, as of today, 33 states plus the District of Columbia have passed state-based crowdfunding laws and other limited offering exemptions. Numerous small businesses rely on those laws to raise money and further their business objectives. Nevertheless, state securities regulators have concerns with proposed Subtitle P. First, it removes individual and aggregate investment caps. As NASAA commented during Congressional consideration of the JOBS Act, one of the fundamental tenets of securities law is to require securities sellers to disclose sufficient information to investors to protect and allow them to make informed decisions. Post-sale antifraud remedies provide little comfort to an investor who has lost a significant sum of money that is unrecoverable. In the case of federal crowdfunding, investors are largely unaccredited and many are unsophisticated or first-time investors. Given that most U.S. households have a relatively modest amount of savings, eliminating the cap can expose many more American families to potentially crippling financial harm. Similarly, no cap on the aggregate investment amount makes this provision inconsistent with the expressed rationale for the

[25] For example, an issuer can raise funds under Rule 504, Section 3(a)(11) of the Securities Act of 1933 ("1933 Act") and its safe harbor Rule 147, and Section 4(a)(2) of the 1933 Act. Most states also have de minimus offering exemptions, allowing issuers to raise money with a limited number of purchasers through self-executing exemptions with little or no notice filing requirements. Finally, amendments recently finalized by the SEC to Rules 147 and 504 will significantly increase the utility of those exemptions. Small issuers can similarly rely on federal crowdfunding rules and Regulation A.

[26] Under 506(b), however, the non-accredited investors must nevertheless be sophisticated, must receive a disclosure document containing certain information, and cannot be solicited via general solicitation.

crowdfunding exemption. A company wanting to raise large sums of investment capital must do so consistent with the laws applicable to such an endeavor, including the registration and filing requirements.

Subtitle P also would allow an issuer to conduct federal crowdfunding without a registered intermediary (an important gateway protection when unsophisticated investors are being solicited), and removes a significant amount of the currently existing regulatory requirements on intermediaries and issuers that protect investors. For example, it removes the requirement that an intermediary protect the privacy of information collected or that an issuer provide a description of its financial condition including certain tax returns and other financial statements. It removes many required disclosures to investors and ongoing reporting to the SEC, and removes all liability for material misstatements and omissions. It also fails to prohibit directors, officers, or partners of an intermediary from having a financial interest in an issuer. Finally, this language amends the current federal crowdfunding regime by prohibiting a state from imposing any fees under authority reserved to the states. While states argued that their registration and review authority should not be preempted under Title III of the JOBS Act, Congress reserved to the states their full enforcement authority, including the imposition of fines or related fees, and the authority to require notice filings and fees. Any attempt to prevent states from collecting fees or imposing fines for improper conduct is misguided, and restricting a state's enforcement authority completely undermines the deterrence that comes with such authority.

This rewritten federal crowdfunding bill will further delay the maturation of this new marketplace, and implement worrisome and dangerous provisions that strip the carefully considered Title III of many of its investor protections. The bill prevents state securities regulators from ensuring that investors do not lose significant and unrecoverable savings. If Congress is poised to enact policies intended to strengthen the economy, this provision will have precisely the opposite effect.

Subtitle H—Small Business Credit Availability

As NASAA has testified extensively in the past,[27] Subtitle H would relax portfolio strictures, leverage limits, and other regulations for business development companies ("BDCs"). BDCs are regulated, closed-end investment firms that invest in small, developing or financially troubled companies. Although governed by the Investment Company Act of 1940 ("ICA"), BDCs are unique in that they enjoy a number of important exemptions from the ICA. For instance, BDCs are permitted to use more leverage than a traditional mutual fund—up to and including a 1-to-1 debt-to equity ratio, and BDCs can engage in affiliate transactions with portfolio companies. BDC managers also have access to "permanent capital" that is not subject to shareholder redemption. In exchange for such regulatory latitude, BDCs must adhere to certain portfolio strictures not applicable to other registered funds. Most prominently, BDCs are required to maintain an asset coverage ratio of 200%, at least 70% of which must be in certain "eligible" investments. In addition, under Section 12(d)(3) of the ICA, a BDC generally cannot acquire securities issued by a broker-dealer, an underwriter or an investment adviser of an investment company, or a registered investment adviser, except under limited circumstances.

Subtitle H would alter the restrictions currently imposed on BDCs. It would allow BDCs to invest in investment advisers and an "eligible portfolio company" that includes a list of enumerated investment companies, other than a private equity company or hedge fund, thus resulting in a diversion of BDC funds

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[27] *See* Letter from Judith Shaw, Maine Securities Administrator and NASAA President, to the Hon. Jeb Hensarling, Chairman, House Committee on Financial Services and the Hon. Maxine Waters, Ranking Member, House Committee on Financial Services, dated Nov. 2, 2015 available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/NASAA-Letter-to-HFSC-Regarding-November-3-2015-Markup.pdf

from the companies that BDCs were intended to benefit. NASAA appreciates that language in the provision permits the SEC to address potential conflicts of interest with investment advisers, but remains concerned about such conflicts. For example, if an advisory firm were among a BDC's portfolio of companies, an incentive could exist for the investment adviser to recommend, or even push, clients toward investments in the BDC or its other portfolio companies. Such conflicts of interest could be even more troublesome in the context of an investment adviser's discretionary or "managed" accounts, where the adviser is delegated authority to make investment decisions on behalf of the client. These inherent conflicts could interfere with an investment adviser's fiduciary obligations to its clients and the BDC as a shareholder. Finally, such conflicts may allow a BDC to access the advisory firm's pool of capital to shore up an underperforming portfolio company. No such conflicts of interest exist now, and NASAA urges Congress not to enact legislation that would create such conflicts as it considers reforms to BDC portfolio strictures.

The proposed language also would have an adverse impact on BDC transparency and increase the risk to retail investors. It would redefine an eligible portfolio company as almost any type of investment company, other than a private equity company or hedge fund, and provides that a BDC may invest up to 50% of its "total assets" (20% more than currently allowed) in any type of eligible or non-eligible company. Because BDCs are frequently "blind pool" offerings, retail investors may only receive broad, vague disclosures about the underlying investment portfolio. It is these retail investors who would bear the loss if the BDC invested in riskier products such as payday lenders and installment programs, REITS, or other structured products.

Finally, NASAA continues to question the rationale for further expanding the leverage limits applicable to BDCs. Excessive leverage comes with increased risk as was the case with many of the largest financial institutions that had to be bailed out by the federal government during the financial crisis. Adjusting the leverage limits applicable to BDCs has inherent potential to put retail investors at significantly increased risk. If Congress ultimately concludes that a modest adjustment to BDC asset coverage ratios for well-established BDCs is in order, it should carefully consider the increased risks that such changes could create for retail investors, and examine what, if any, steps can be taken to mitigate such risks.

Subtitle T—Private Company Flexibility and Growth

Section 12(g) of the Securities Exchange Act of 1934 was enacted to ensure that as companies grew and became more complex, so would their disclosures to investors, such that ultimately companies could not avoid becoming public reporting companies once their assets and shareholder base reached a certain threshold. Already creative shareholder recording methods (such as "beneficial" shareholders relying on brokers, banks and other intermediaries) allow companies to avoid mandatory reporting. The JOBS Act increased the shareholder threshold from securities "held of record" by 500 persons, to securities "held of record" by either 2,000 persons, or 500 persons who are not accredited investors. That law also exempted crowdfunding investors and for purposes of the shareholder threshold calculation as well as securities held by shareholders under employee compensation plans. This provision of the JOBS Act is often overlooked but has played a role in the expansion of the private markets to the detriment of the public IPO markets.

Further increasing this threshold under Subtitle T (both for Section 12(g) registration and deregistration) would allow even more private companies to avoid public reporting and rely on existing exemptions from registration (i.e., Rule 506 of Regulation D, Regulation A, crowdfunding) when issuing shares. Subtitle T also removes the 500 non-accredited investor threshold, thus allowing a company to have up to 2,000 non-accredited investors who do not have the benefits of a public reporting company. These benefits include enhanced transparency (e.g., publishing quarterly reports, holding shareholder meetings, etc.), allowing retail investors to participate in the economy and grow their wealth, and permitting investors to freely trade their shares.

Subtitle U—Small Company Capital Formation Enhancements

Subtitle U, "JOBS Act-Related Exemption" would increase the aggregate offering limit under Regulation A+ (Section 3(b)(2) of the Securities Act) from $50 million to $75 million and automatically adjust this amount for inflation every 2 years.[28] As with federal crowdfunding, Regulation A+ has not been effective for a sufficient amount of time to make decisions regarding needed adjustments. The Commission adopted final rules on March 25, 2015, and the rules became effective June 19, 2015. It has been less than two years since the rules took effect, and the Commission is still evaluating their effectiveness and considering whether revisions are necessary or prudent. NASAA questions the reasoning behind further increasing the aggregate offering amount and recommends that Congress make those determinations after the market has matured and there is a sufficient regulatory record in place.

Section 860. Definition of Accredited Investor

NASAA opposes the provisions in Section 860 that would codify the existing income and net worth standards of the accredited investor definition and direct the SEC to establish new untested means for persons to qualify as accredited investors. Such categories would include natural persons who are licensed or registered as a broker-dealer or investment adviser, and natural persons who the SEC determines, by regulation, have "demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment."

As the Government Accountability Office and others have discussed, dollar thresholds have never been an accurate proxy for investor sophistication.[29] Congress should refrain from embedding such flawed metrics, and new untested criteria, into our nation's securities laws. Further, on December 18, 2015, the SEC issued a Dodd-Frank Act mandated report on the definition of accredited investor, making recommendations on potential changes.[30] Congress should allow the SEC to review those findings and any staff recommendations, prior to taking steps to codify additional changes to the accredited investor definition.

Sec. 401. Registration exemption for merger and acquisition brokers

Section 401 of the Financial Choice Act would establish an exemption from registration requirements under federal securities laws for persons serving as brokers in certain merger and acquisition deals ("M&A brokers"). State securities administrators share Congress's interest in establishing a more streamlined regulatory framework for persons serving as brokers in M&A deals that involve the transfer of securities, subject to certain conditions, including (1) the disqualification from the exemption of any broker or associated person who is a bad actor, or subject to suspension or revocation of registration; and (2) the inapplicability of the exemption to any M&A transaction where one party or more is a shell company.

[28] Prior to the enactment of the JOBS Act, the offering cap for Regulation A was $5,000,000. The increase of the offering cap to $50,000,000 represents a 900% increase in the cap. Raising the cap to $75,000,000 would represent a 1400% increase from the initial $5,000,000 cap.

[29] United States Government Accountability Office Report. "Alternative Criteria for Qualifying As An Accredited Investor Should Be Considered." GAO-13-640. (July, 2013).

[30] Section 413(b)(2)(A) of the Dodd-Frank Act directs the SEC to review the accredited investor definition as it relates to natural persons every four years to determine whether the definition should be modified or adjusted for the protection of investors, in the public interest and in light of the economy. The first report is available at sec.gov/corpfin/reportspubs/special-studies/review-definitionof-accredited-investor-12-18-2015.pdf. NASAA submitted a detailed comment letter in response to this recommendation on May 25, 2016, which is available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/NASAA-Accredited-Investor-Comment-Letter-05252016.pdf.

NASAA supported legislation identical to Section 401 when it was passed by the House as a provision of a broader legislative package in 2016[31] and continues to support the provision. We also note the federal exemption established by Section 401 closely mirrors a recently adopted NASAA Model Rule which exempts M&A brokers from state securities registration pursuant to certain conditions.[32]

Other Capital Formation Sections

NASAA continues to have questions about additional provisions that impact the capital markets and securities regime.[33]

C. Other Provisions of Significant Concern

In addition to the provisions addressed above, NASAA is concerned with the following provisions in the Financial Choice Act.

Section 841—Retail Investor Protection Act

NASAA strongly opposes Section 841 of the Financial Choice Act. This provision would, among other things, invalidate the rule recently adopted by the U.S. Department of Labor ("DOL") until after the SEC issues its own final rule relating to standards of conduct for brokers and dealers, and effectively prevent the DOL from undertaking any future rulemaking regarding the conduct of brokers and dealers in the management of retirement accounts. Section 841 also would impose additional regulatory, analytical, and economic analysis requirements on the SEC prior to any rulemaking. These provisions would only create significant obstacles to any future SEC rulemaking aimed at raising the standards of conduct applicable to broker-dealers.

While the DOL's fiduciary rule remains distinct from any SEC rulemaking pursuant to Section 913 of the Dodd-Frank Act, NASAA continues to advocate on multiple initiatives to raise the standard of care for the benefit of investors.[34] With Americans living longer and, in many instances, with fewer funds available for retirement, it is absolutely essential that fundamental legal protections for the assets they do have are in place in the form of fiduciary laws—such as the Employee Retirement Income Security Act of 1974 and the Investment Advisers Act of 1940. Further, any nullification of the DOL's fiduciary rule or any attempt to thwart meaningful rulemaking by the SEC would be a profound disservice to investors.

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[31] *See* Letter from Judith Shaw, Maine Securities Administrator and NASAA President, to the Hon. Bill Huizenga, dated Feb. 3, 2016 available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/NASAA-Letter-on-Huizenga-Amendment-to-H-R-1675.pdf

[32] On September 29, 2016, NASAA adopted a Model Rule Exempting Certain Merger & Acquisition Brokers from Registration. The NASAA Model Rule is available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/MA-Broker-ModelRule-adopted-Sept.-29-2015.pdf

[33] For example, NASAA questions: (a) whether additional investor protections should be included in Subtitle K - Helping Angels Lead Our Startups; (b) the removal of important investor protections in Subtitle G - Enhancing the RAISE Act - which has already been enacted into law; (c) unnecessary delay of enactment of XBRL in Subtitle C - Small Company Disclosure Simplification; (d) substantially increasing the Rule 701 thresholds from a bill that already passed the House in this Congress in Subtitle B - Encouraging Employee Ownership; and (e) expanding the qualifying investor limitation for a qualifying venture capital fund in Subtitle O- Supporting America's Innovators; among other provisions.

[34] *See* Letter from Mike Rothman, Minnesota Commerce Commissioner and NASAA President, to U.S. Department of Labor, dated March 16, 2017 available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2017/03/20170316-Comment-Letter-to-DOL-re-Rule-Delay.pdf

Section 857—Repeal of Authority to Restrict or Prohibit Mandatory Arbitration

Section 857 of the Financial Choice Act would repeal Section 921 of the Dodd-Frank Act, which was enacted in direct response to Congressional concern that mandatory pre-dispute arbitration agreements were unfair to investors.[35] The provision gives the SEC explicit rulemaking authority to prohibit, condition or limit the use of mandatory pre-dispute arbitration agreements if it finds that doing so is in the public interest and for the protection of investors.

NASAA has long been concerned with the widespread use of mandatory pre-dispute arbitration clauses in customer contracts used by broker-dealers and, more recently, investment advisers as well.[36] Investors must have a choice of forum when it comes to resolving disputes with their investment professionals. Investor confidence in fair and equitable recourse is critical to the stability of the securities markets and long-term investments by retail investors. As NASAA and others have previously noted, participation by "mom and pop" investors in our capital markets, and, by extension, job growth, is directly tied to their level of trust in having a reasonable avenue to seek recovery if they are victimized by securities fraud or other unethical conduct.

While the SEC has not taken action to limit mandatory pre-dispute arbitration pursuant to its authority under Section 921, this does nothing to alter the fact that the recent proliferation in the use of such contracts by investment professionals is fundamentally harmful to many investors. We urge Congress to retain this important authority and remove this language from the bill.

Section 858—Exemption of and Reporting by Private Equity Fund Advisers & Section 859 – Records and Reports of Private Funds

Sections 858 and 859 of the Financial Choice Act would unnecessarily weaken oversight of advisers to private-equity funds, including by repealing important provisions in the Dodd-Frank Act that require the registration and reporting of advisers to such funds. As recent SEC examinations have revealed, the scrutiny of advisers to private funds is important to the protection of investors in such funds, including limited partners, and even certain state pension funds. The registration of private fund advisers has brought much needed transparency to a significant segment of the markets.[37]

NASAA strongly urges Congress to refrain from repealing provisions of the Dodd-Frank Act that provide appropriate and overdue scrutiny of advisers to private funds.

Section 332—Congressional Approval Procedure for Major Rules

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[35] Congress considered the following concerns about the arbitration process: "high upfront costs; limited access to documents and other key information; limited knowledge upon which to base the choice of arbitrator; the absence of a requirement that arbitrators follow the law or issue written decisions; and extremely limited grounds for appeal." *See* Senate Committee on Banking, Housing, and Urban Affairs on S. 3217, S. Rep. No. 111-176, at 110.

[36] *See* Letter from Secretary William F. Galvin of the Commonwealth of Massachusetts to SEC Chair Elisse B. Walter and SEC Commissioners Tory A. Paredes, Luis A. Aguilar, and Daniel M. Gallagher, dated Feb. 12, 2013, *available at* http://sec.state.ma.us/sct/sctarbitration/arbitration-letter.pdf (citing a Massachusetts Securities Division survey to 710 state registered Massachusetts investment advisers, which indicated that of the more than 50% of surveys received, nearly half of the investment advisers included a binding pre-dispute arbitration clause in their advisory contracts).

[37] *See* Prepared remarks of Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, SEC, Private Equity International (PEI), Private Fund Compliance Forum 2014, New York, NY. (May 6, 2014), *available at* https://www.sec.gov/news/speech/2014--spch05062014ab.html.

Section 332 of the Financial Choice Act would require Congress to pass, and the President to sign, a joint resolution of approval for all major rules published in the Federal Register.[38] This radical provision would upend decades of federal administrative law practices dating back to the 1930s. Its potential to dramatically and adversely impact the ability of regulatory agencies to take actions to implement laws intended to protect the investing public is self-evident. NASAA strongly opposes requiring affirmative Congressional and Presidential approval of regulations, and we similarly oppose any attempt to impose debilitating, unreasonable and unrealistic hurdles on independent agencies engaged in rulemaking.

Section 341—Scope of Judicial Review of Agency Action

Section 341 would undo nearly two centuries of Supreme Court precedent in which the Court has affirmed that deference to federal agencies is a good jurisprudential practice. The Court's 1984 *Chevron* decision is the most widely recognized case in this regard.[39] But *Chevron* was merely a logical consequence of Court precedents dating as far back as 1827.[40] Deference to federal agencies is good policy because federal agencies, much like a rudder on a ship, provide an inherently stabilizing force to the development of administrative law. Upending the longstanding tradition of agency deference would inevitably result in greater policy discontinuities, to the detriment of American businesses and families.

The conclusion that deference to administrative agencies is ultimately good for the American people is reinforced by the fact that states roundly accept this practice. State legislatures and state courts defer to state administrative agencies on the interpretation of state laws and rules which those agencies administer not because they have to—*Chevron*, of course, does not bind the states—but because they have considered this issue and concluded that deference works. It would be a mistake for the federal government to abort this principle.

Section 811—Duties of SEC Investor Advocate

NASAA strongly opposes provisions in the Financial Choice Act that would weaken the independence and influence of the SEC's Office of the Investor Advocate. Specifically, Section 811 would restrict the SEC Investor Advocate's authority to express views regarding legislation introduced in Congress, except in regard to a legislative change proposed by the Investor Advocate, and also would require the Investor Advocate to consult and coordinate activities and recommendations with unrelated SEC advisory committees. In NASAA's view, such requirements are unnecessary and would undermine the ability of the Investor Advocate to speak as an independent voice for the interests of retail investors.

Section 831—Complaint and Burden of Proof Requirements for Certain Actions for Breach of Fiduciary Duty

Section 36(b) of the Investment Company Act (ICA) provides mutual fund investors with a cause of action against mutual fund investment advisers that charge investors excessive advisory fees. Section 36(b) is the only private cause of action in the ICA. In 2010, the Supreme Court adopted the so-called *Gartenberg* test as the proper standard for Section 36(b) claims.[41] This test poses a significant hurdle to

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[38] Section 334 of the Financial Choice Act defines the term major rule as any rule or interim final rule that the Office of Management and Budget find has resulted in or is likely to result in (A) an annual effect on the economy of $100 million or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State or local government agencies; or significant adverse effects on competition, employment, investment, productivity or innovation.

[39] *Chevron v. Nat'l Resources Def. Council*, 467 U.S. 837 (1984).

[40] *Edwards' Lessee v. Darby*, 25 U.S. 206 (1827).

[41] *Jones v. Harris Assoc.*, 559 U.S. 335 (2010).

plaintiffs, who must show that an adviser charged a fee "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining."[42]

Section 831 would place two additional burdens on investors by elevating the pleading standard and burden of proof in Section 36(b) claims. This would make it nearly impossible for investors to succeed in 36(b) cases. First, raising the pleading standard will put investors in a Catch-22: they will be required to plead specific facts that show an adviser's fee was excessive yet they will have no ability at this stage of litigation to discover these facts through subpoenas for documents or testimony. Second, elevating the burden of proof in Section 36(b) claims from a preponderance to clear and convincing evidence standard would put a nearly insurmountable hurdle in investors' way if they even could successfully plead their claims. Indeed, Section 831 would tip the scales of justice in Section 36(b) disputes strongly in favor of investment advisers, to the detriment of average American retail investors.

IV. Conclusion

In conclusion, NASAA's message to Congress is simple and clear: Please continue your commitment to protecting investors and do not undermine the important and overdue reforms implemented in the wake of the financial crisis, either directly through legislative repeals, or indirectly through a lack of appropriate funding or delayed execution. The financial crisis that struck our country is not some distant memory in the minds of hard-working Americans. The distress that comes with the loss of retirement savings built up over many years is devastating. It is, therefore, incumbent upon members of Congress and regulators to demonstrate an unwavering commitment to Main Street investors and continue to take the steps necessary to protect them. Their confidence in knowing that the "cops are on the beat" is integral to the success and integrity of our nation's markets. NASAA looks forward to working cooperatively with the Committee, as well as all members of Congress and fellow regulators, to ensure Americans continue to benefit from effective regulation, strong investor protection, and robust and transparent capital markets.

Thank you again for the opportunity to provide this statement for the hearing record, and for your consideration of NASAA's views on the Financial Choice Act.

[42] *Id.* at 344.

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STATEMENT OF
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HEARING ON THE
"FINANCIAL CHOICE ACT OF 2017"

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 28, 2017

Members of the Committee, my name is Rob Randhava, and I'm here today as senior counsel with the Leadership Conference on Civil and Human Rights. Founded in 1950 at the outset of the American civil rights movement, The Leadership Conference has grown to represent more than 200 national advocacy organizations that are working, as we like to say, to build an America as good as its ideals. I'm also a member of the steering committee of Americans for Financial Reform, and a founding member of the Asset Building Policy Network.

I want to thank the Committee for inviting me to present the Leadership Conference's views on the Financial CHOICE Act. I must admit that we were torn about participating. For us, this bill is a nonstarter – and we're concerned about giving it an air of legitimacy that we just don't believe it deserves.

We limited our review of the bill to the parts affecting the Consumer Financial Protection Bureau and its policies. There are other witnesses here today, and other consumer protection organizations that have written in, who can do a much better job than I can of fully analyzing those provisions, as well as the rest of the bill. So I won't try to do that here.

But I will say what we think in general about the CFPB and its policies. We speak as an organization that, for years before the financial crisis, begged Congress and federal regulators to put a stop to the deceptive, "anything goes" kind of lending that was running rampant, including in communities of color. Some members – like former Congressmen Barney Frank and Brad Miller – did share our concerns and tried to push for stronger regulations.

But for the most part, we were ignored. I can't tell you how many times I heard the phrase "access to credit" being used to justify things like "2/28" or "pick-a-payment" mortgages. We joined with consumer groups like the Center for Responsible Lending when it predicted, two years before the crisis, that there would be a wave of millions of foreclosures – only to hear CRL accused of "betting against housing."

So when the crisis did hit – and when some on this committee had the audacity to blame it all on people and groups that had been trying to prevent it, or on the Community Reinvestment Act – you can bet that we were very involved in the effort to create a better system with Dodd-Frank.

Ever since the CFPB opened its doors, it has worked tirelessly to advance the financial health of the communities we represent – not just carrying out the once-radical idea of "ability to repay" rules, but trying

to address racial discrimination in auto lending markups, sneaky credit card add-ons, and many other deceptive and abusive practices. The CFPB and Director Cordray have done their best to apply the law to bad actors, give clear guardrails to the good ones, and put billions of dollars back in the pockets of consumers who have been ripped off. At the same time, they've worked to promote consumer education and the growth of more inclusive financial technology.

I'm stunned that anyone can be troubled by a record like that – and even more stunned by the intensity of the emotions, when we hear the CFPB described as a "dictatorship" and a "tyranny" by some members of this Committee.

To that kind of rhetoric, I'll just say this: given our involvement in Dodd-Frank, I'm happy to say that various parts of the industry, who are regulated by the CFPB, have engaged The Leadership Conference on consumer finance policies.

We have good relationships with the nation's largest banks, and we've found common ground on the value of getting consumers into the mainstream banking system. We've sided with organizations like the Mortgage Bankers Association and National Association of Realtors to call for some reasonable flexibility in mortgage downpayment requirements. We've teamed up with community bankers and mortgage lender organizations, who share our interest in a level playing field within a healthy GSE system. We worked with CFS2, a debt buyer company headed by the late great Bill Bartmann, to call for debt collection practices that allow companies to earn reasonable returns while putting debtors on the road back to financial health. And thanks in part to the Bipartisan Policy Center and the Center on Financial Services Innovation, we've engaged small-dollar lenders and fintech companies that recognize the real need for underbanked communities to obtain credit and that believe they can work with the rules being proposed by the CFPB in this area.

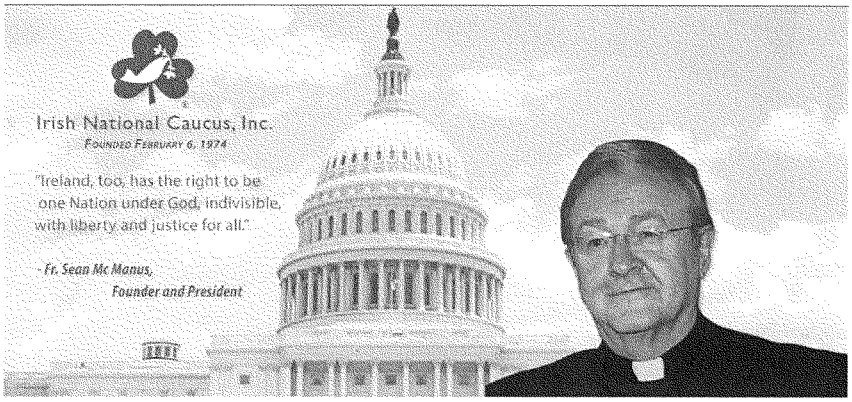
Of course we've disagreed on a lot of issues as well – but we've been glad to engage the industry, and we'd like to even more in the future. And the CFPB constantly does the same. We want the system to work – for providers and consumers – and if policies need to be fine-tuned for that to happen, we're all ears.

But nobody has engaged us in two-way conversations about a "dictatorship" or "tyranny" at the CFPB. So when we hear the need for legislation described in those terms, I honestly don't know how to engage that legislation in a serious way.

The Leadership Conference was proud of Ranking Member Waters last fall when she called last year's markup a "charade" and declined to prolong it. However members handle next week's markup, I would suggest that the real fight over this bill should be in the court of public opinion. Rest assured, the public isn't clamoring for this bill – in fact, multiple polls have shown strong bipartisan support for the CFPB's work. And over and over again, the bad apples in the industry keep writing the talking points for us.

One of the best examples of this was seen in last November's vote on a South Dakota initiative to outlaw payday lending. That vote – down the ballot, mind you – had almost as much participation as the vote for President, and a whopping 75 percent called for putting an end to the kinds of debt traps that the Financial CHOICE Act would enable. In other states to vote on payday lending, the results have been the same – and voters aren't suffering or clamoring for a return to the old days of unchecked triple digit interest rate loans.

But if the supporters of the Financial CHOICE Act want to pick this fight, then The Leadership Conference will not hesitate to join in, continue educating the public, and give this bill the pushback it deserves.



Irish National Caucus, Inc.

Irish-Americans Outraged by Congressional Proposal to Kill Shareholders' Resolutions

Posted By: April 18, 2017

Sean Mc Manus with Congressman Ben Gilman (R-NY) in 1989.

Plan would sabotage Mac Bride Principles

CAPITOL HILL. Tuesday, April 18, 2016— A Congressional move to, in effect, eliminate shareholders' advocacy for worthy causes has caused outrage among Irish-Americans.

For many years, such advocacy—for social, governance, and environmental (ESG) concerns— was open to any group or person who owned $2,000 worth of shares for one year. But a new proposed bill before the House Financial Service Committee would rob the average American of this important right, placing it only in the hands of

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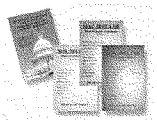

Read Fr. Sean McManus' inspiring story ...

His life-long struggle for justice in Northern Ireland, now combines with The

the mega-rich and billionaires. The radical change is being proposed by the Financial Services Committee Chairman Jeb Hensarling (R-Texas).

The President of the Capitol Hill-based Irish National Caucus — which launched the Mac Bride Principles on November 5, 1984 — has written to all 64 members of the Financial Service Committee condemning the proposal: 'This would amount to a flagrant attack on America's founding principle: 'We the people.' It would outrageously eliminate millions of citizens and the average American from having a say on the conduct of publicly held companies. The ordinary citizen, investor, consumer, and stakeholder is dismissed, leaving only the super- rich with any say. So, for example, this would mean that in order to submit a proposal to Wells Fargo one would have to own $2.5 billion in shares, whereas at present one only needs to have owned $2,000 worth of shares for one year."

Mac Bride Principles

The Irish-born priest led the campaign to have the Mac Bride Principles—a corporate code of conduct for American companies doing business in Northern Ireland— enshrined into U.S. law in 1998.The Principles were passed twice by the Republican-controlled Congress and signed into U.S. law by Democratic President Clinton. Furthermore, 116 companies have agreed to implement the Mac Bride Principles, and the Principles have been passed into law by 18 States and numerous cities and towns. Fr. Mc Manus reasons to the Financial Service Committee: "What American can possibly condone this? And what Member of Congress would vote for it— to take away the voice of the ordinary citizen, franchising only the mega- rich? It is undemocratic, un-American and surely should be the third rail of American politics for all Members of Congress. This is an affront to all Americans. From a specifically Irish-American perspective, it would be the death-knell for the most effective campaign ever against Anti-Catholic discrimination in Northern Ireland: the Mac Bride Principles."

Fr. Mc Manus also tells the Financial Service Committee: "Therefore, this terrible initiative is not only an attack on basic American values but it will be

Holy Land ...

Order your copies of "My American struggle for Justice in Northern Ireland... and the Holy Land —" as well as "Mac Ireland series: Books One, 2 and 3."

Read More

seen as an attempt to sabotage the Mac Bride Principles—which have played a key role in promoting equality and non-discrimination in employment in Northern Ireland, thereby making a vital contribution to the Irish peace process.
I am totally confident in saying that the Irish National Caucus is reflecting the opinion of the majority of concerned Irish-Americans—Republicans and Democrats alike— when I respectfully

ask you to take a strong stand against this un-American attempt to silence the voices of ordinary American citizens."
Fr. Mc Manus concludes his letter with, "Please respond promptly as we are publishing the position of all the Financial Service Committee members on this vital issue for Irish-Americans."

NEW YORK CITY COMPTROLLER
SCOTT M. STRINGER

Statement of New York City Comptroller Scott M. Stringer on the April 19th Discussion Draft of the Financial CHOICE Act of 2017 (Act)

New York, NY, April 25, 2017 – As Comptroller for the City of New York, I am the chief investment advisor and custodian of assets of the five New York City Pension Funds (NYC Pension Funds) and a trustee of four of them.

The NYC Pension Funds are long-term shareowners of more than 3,000 U.S. public companies and are the fourth largest public pension system in the United States, with $170 billion in assets under management. Our funds have likely filed more than 1,000 shareholder proposals, almost certainly more than any other institutional investor in the world, with a record dating back 30 years.

Section 844 of the draft Act includes provisions that would dramatically change the shareholder proposal process, and block the ability of the NYC Pension Funds to submit shareholder proposals. Currently, under the U.S. Securities and Exchange Commission (SEC) Rule 14a-8, shareowners who own 1% or $2,000 worth of outstanding shares for at least one year can submit a single proposal to be included in a public company's proxy statement. Section 844(b) of the draft Act would eliminate the $2,000 threshold and require investors to hold a minimum of 1% of the issuer's voting securities over a three- year holding period.

The NYC Pension Funds have a proud record of engaging our portfolio companies on a broad range of environmental, social, and corporate governance issues, and thereby working to enhance long-term shareowner value, often through shareowner proposals. Despite being among the largest pension investors in the world, we rarely hold more than 0.5% of any individual company, and most often hold less. As a result, the Act, if enacted, would effectively prevent our funds entirely from participating in the shareholder proposal process.

Shareholder proposals have been an important tool for the NYC Pension Funds to prompt constructive engagement on specific concerns that benefit the investing public, both financially and socially. A few of our most recent and most impactful efforts directly resulting from our shareholder proposals include the following:

In 2014, we launched the Boardroom Accountability Project—an effort to enact proxy access on a company-by-company basis in the U.S. market. At the time, just a handful of U.S. companies had proxy access bylaws, which allow shareowners to nominate one or more directors to a company's board of directors, and require the company to list those nominees on the company's proxy voting card. Today more than 400 companies, including 58% of the S&P 500, have proxy access bylaws. A July 2015 study by economic researchers at the SEC analyzed the public launch of the Boardroom Accountability Project and found a 0.5% average increase in shareowner value at the targeted firms. The findings were consistent with the 2014 CFA Institute study that found that proxy access on a market-wide basis has the potential to raise U.S. market capitalization by as much as 1%, or $140 billion.

The NYC Pension Funds for many years have fought for strong policies to enable boards to claw back compensation from senior executives responsible for egregious misconduct that causes financial or reputational harm to their companies. In 2013, we successfully negotiated this enhancement to Wells Fargo's clawback policy. The policy then enabled the Wells Fargo board of directors to announce in September 2016 that it would recoup $41 million from CEO John Stumpf and $19 million from former Senior Vice President Carrie Tolstedt in order to hold them financially accountable for the credit card scandal which cost 5,300 lower-level employees their jobs and cost Wells Fargo $185 million in fines and penalties.

Our shareholder proposals have encouraged many companies to adopt anti-discrimination practices, including stepping up board diversity and disclosing data on work force composition by race and gender. Studies have found that board and workforce diversity enhances financial returns. The NYC Pension Funds were early and vocal proponents of corporate policies against workplace discrimination based on sexual orientation or gender identity. Now, almost 90% of Fortune 500 companies prohibit discrimination based on sexual orientation, and two-thirds prohibit discrimination based on gender identity.

Our diversity focus has recently expanded to include gender pay equity. We filed proposals at major insurance and health care companies—two industries that have the highest adjusted gender pay gaps in the nation—to disclose information on how they address gender pay equity. In response:

- AIG released information on how it reviews employee salaries and has worked to ensure women and men are compensated equally;
- Aflac committed to disclosing its female to male salary ratio, opportunities for advancement, and details on board oversight of compensation and benefits in its next Corporate Social Responsibility report;
- Allstate committed to publish a diversity report discussing its annual compensation review process, gender pay equity adjustment policies, opportunities for advancement, and details on board oversight of diversity efforts; and
- Anthem and UnitedHealth Group agreed to conduct additional analyses on gender pay equity.

The following are among other policies advocated over the years in our shareholder proposals that now have wide acceptance:

- Substantial independent majorities on boards of directors
- Enhanced standards of independence for members of company audit and compensation committees
- Independent nominating committees
- Annual election of all directors
- Majority vote standards in election of directors
- Annual sustainability reporting
- Shareholder advisory votes on executive compensation
- Emphasis on performance-based awards in executive compensation; and
- Shareholder votes to ratify auditors

All of the above achievements and many more were made possible because of the NYC Pension Funds' long standing right and ability to file shareholder proposals—a right and ability that would be pointlessly eviscerated by the passage of the Act.

Should the Financial Services Committee desire greater details about the impact of the draft Act on the work of the New York City Comptroller's Office and the NYC Pension Funds, please reach out to Michael Garland in our Office at mgarlan@comptroller.nyc.gov or (212) 669-2517.

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NWC | NATIONAL WHISTLEBLOWER CENTER

3238 P Street, N.W. | Washington, D.C. 20007 | (202) 342-1903 | www.whistleblowers.org

Testimony before the United States House of Representatives
Committee on Financial Services

"Regulatory Reforms to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs"

April 28, 2017

By:

Stephen M. Kohn[1]
Executive Director
National Whistleblower Center[2]
sk@whistleblowers.org

Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

Thank you for the opportunity to submit testimony on behalf of the National Whistleblower Center ("NWC"), a nonprofit, non-partisan, tax exempt organization founded in 1988. This testimony concerns § 823 of the Committee Discussion Draft of the Financial Choice Act of 2017 ("Discussion Draft"), the section that directly impacts the whistleblower protections afforded under the Securities and Exchange Act ("SEA").

Discussion Draft § 823 purports to exclude opportunistic individuals from the SEA's reward provisions if they are "culpable" for the violation for which they are reporting. This amendment is not needed and, in fact, would undermine the SEA's highly successful whistleblower law.

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[1] Stephen M. Kohn is a founder and the executive director of the National Whistleblower Center. He served as the Director of Corporate Litigation for the Government Accountability Project from 1984-88 and is currently a partner in the law firm of Kohn, Kohn & Colapinto, LLP and an adjunct professor at Northeastern University School of Law, where he teaches a seminar on whistleblower law. In 1985, he published the first-ever book on whistleblower law, and his eighth book on the subject is the highly acclaimed *The New Whistleblower's Handbook* (Lyons Press, 2017).

[2] For nearly 30 years, the National Whistleblower Center has provided testimony and expert advice to Congressional and regulatory officials on matters related to advancing whistleblower protections. NWC proposals have been adopted in various U.S. whistleblower laws, including in the Whistleblower Protection Enhancement Act, Sarbanes-Oxley Act, and Dodd-Frank Act. Last year, the NWC's program to protect whistleblowers who disclose international wildlife trafficking was awarded a Grand Prize in the highly competitive Wildlife Crime Tech Challenge—an initiative of the U.S. Agency for International Development, in partnership with the Smithsonian Institution, National Geographic Society, and TRAFFIC.

Under the rules already approved by the U.S. Securities and Exchange Commission ("SEC" or "Commission"), "culpable" whistleblowers are excluded from profiting from their own misconduct. The SEC's current rule is consistent with similar restrictions in other reward and whistleblower anti-retaliation laws. There is simply no reason to adopt the amendment set forth in the Draft Discussion document. Conversely, there are numerous reasons not to adopt the amendment, as it is overbroad and would seriously undermine other aspects of the SEC's whistleblower program. Section 823 would harm investors, make investigations more costly and difficult, undercut the confidentiality provisions in both the SEA and the Sarbanes-Oxley Act ("SOX"), and prejudice employees seeking to do the "right thing" by taking the risk of losing their jobs and careers by lawfully reporting securities fraud to the appropriate authorities.

For these reasons, we ask that § 823 of the Discussion Draft be removed from the bill.

I. THE SEC WHISTLEBLOWER PROGRAM IS HIGHLY SUCCESSFUL AND SHOULD NOT BE UNDERMINED.

The Commission's whistleblower program has been highly successful. Almost $1 Billion has been recovered by investors and the U.S. Treasury directly tied to the original information provided to the SEC under the Dodd-Frank Act's whistleblower program. There are no administrative or judicial decisions criticizing the SEC's whistleblower program, let alone any ruling attacking that program for paying "culpable" whistleblowers money derived from the frauds they commit. As explained in Part II, such payments are already prohibited under the SEC's program.

On April 30, 2015, the former SEC Chair Mary Jo White, in remarks at the Ray Garrett, Jr. Corporate and Securities Law Institute-Northwestern University School of Law Chicago, Illinois, explained that the whistleblower program was working well:

> *[T]he SEC's whistleblower awards program . . . has proven to be a game changer. . . it is past time to stop wringing our hands about whistleblowers. They provide an invaluable public service, and they should be supported.*
>
> * * *
>
> *It has been nearly four years since the SEC implemented its whistleblower program. . . I am here to say that the program is a success . . . We have seen enough to know that whistleblowers increase our efficiency and conserve our scarce resources.*
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> * * *
>
> *As the program has grown, not only have we received more tips, but we also continue to receive higher quality tips that are of tremendous help to the Commission in stopping ongoing and imminent fraud, and lead to significant enforcement actions on a much faster timetable than we would be able to achieve without the information and assistance from the whistleblower. The program has also created a powerful incentive for companies to self-report wrongdoing to the SEC – companies now know that if they do not, we may hear about the conduct from someone else.*
>
> * * *

> *The bottom line is that is that responsible companies with strong compliance cultures and programs should not fear bona fide whistleblowers, but embrace them as a constructive part of the process to expose the wrongdoing that can harm a company and its reputation. Gone are the days when corporate wrongdoing can be pushed into the dark corners of an organization.*

It is absolutely critical that this Committee take no action that would restore the "days when corporate wrongdoing can be pushed into the dark corners of an organization." The SEA whistleblower law targets these "dark corners" and incentivizes key sources of information that have greatly aided the SEC's enforcement policies. Section 823 would undermine this progress, and constitutes a mistaken and troubling step backwards.

II. THE SEC ALREADY ENFORCES A RULE PROHIBITING CULPABLE EMPLOYEES FROM PROFITING FROM THEIR MISCONDUCT.

The SEC engaged in an extensive rulemaking process in 2010-11 regarding the Dodd-Frank Act's whistleblower law. One of the major issues addressed by the Commission was the eligibility of "culpable" individuals to obtain a reward. The Commission correctly reviewed how other laws resolved these matters, and specifically looked at the False Claims Act (the oldest, and most successful, whistleblower reward law in history, signed into law on March 2, 1863 by President Abraham Lincoln). The Commission, without any major objection, instituted a rule that prohibited culpable whistleblowers from obtaining a reward. *See* 17 C.F.R. § 240.21F-16.

This rule now requires the SEC to *exclude* from the definition of collected proceeds "any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planed, or initiated." 17 C.F.R. § 240.21F-16. In other words, if a whistleblower caused the underlying violation for which he or she reported, the whistleblower gets no reward. Thus, the very premise for which § 823 is predicated would serve no necessary purpose since current law already addresses this issue consistent with every other major whistleblower reward law.

The Commission carefully considered the type of overbroad "per se exclusion for culpable whistleblowers" set forth in § 823, and categorically rejected this approach. Instead, the Commission adopted a rule that would encourage the reporting of misconduct committed by other persons, but prohibit whistleblowers from profiting from their own misconduct. The final rule approved by the Commission *prevents* culpable whistleblowers "from financially benefiting from their own misconduct or misconduct for which they are substantially responsible," but would still incentivize whistleblower to disclose misconduct for which they were not personally responsible. *See* 76 *Federal Register* at 34331 (June 13, 2011).

The wording of this SEC rule, and its underlying purpose, is very significant. The rule draws a distinction between mere participants who are ordered to perform work and those who "direct" "plan" or "initiate" the illegal conduct. The justifications for this distinction are well established. If mere participants are excluded from the whistleblower law, law enforcement would lose most, if not all, of their best sources. The law is designed to encourage "insiders" with information to come forward and report corporate wrongdoing.

But under § 823 there is no distinction between a secretary of who may simply mail a letter related to an illegal scheme, and the manager who concocted the scheme and ordered the secretary to send the letter. Most well-placed whistleblowers are insider participants in the

improper schemes. It is just their information that is needed to turn-in those who orchestrated, initiated or planned the frauds. It is their information that is needed to uncover and understand the scope of the illegal conduct, and identify who may be criminally responsible for cover-ups. Without these sources the SEC and Department of Justice would lose its ability to detect clandestine frauds, and protect investors and the public from these crimes. This is precisely the intent behind other very successful whistleblower laws, such as the False Claims Act, and it was the explicit intent behind the FCA when President Lincoln signed it into law.

Section 823, if enacted, would have a devastating impact not just on whistleblowers, but on the ability of law enforcement to obtain the evidence it needs to protect investors. The Commission's explanation for enacting the current rule prohibiting culpable whistleblowers from obtaining a reward is to incentivize those with knowledge to report the planners and initiators of criminal schemes and help SEC detect clandestine activity it would otherwise be unable to uncover. The SEC was clear about the intent behind hits rule. The Commission wanted to incentivize participants, but also *"prevent() culpable whistleblowers from financially benefiting from their own misconduct or misconduct for which they are substantially responsible. . . As commenters noted, the original Federal whistleblower statute—the False Claims Act—was premised on the notion that one effective way to bring about justice is to use a rogue to catch a rogue."*[3]

The Commission quoted directly from Senator Jacob M. Howard's explanation as to why the Civil War Congress enacted the False Claims Act: '

> *I have based (the provisions of False Claims Act) on the old-fashioned idea of holding out a temptation and 'setting a rogue to catch a rogue,' which is the safest and most expeditious way of bringing rogues to justice.*

SEC Final Rule, 76 Fed. Reg. at 34350 (2011), *quoting from* Cong. Globe, 37th Cong., 3d Sess. 955–56 (1863) (emphasis added).[4]

The Commission explained that its rule was predicated on the *"basic law enforcement principle"* that it is *"difficult for law enforcement authorities to detect and prosecute" "sophisticated securities fraud schemes" "without insider information and assistance from participants in the scheme or their coconspirators."* The Commission further explained that *"insiders regularly provide law enforcement authorities with early and invaluable assistance in identifying the scope, participants, victims, and ill-gotten gains from these fraudulent schemes."*[5]

Despite recognizing the importance of insider information, the Commission still precluded insiders from profiting from their own frauds, or frauds for which they planned and initiate: *"The rationale for this limitation is that the common understanding of a whistleblower is one who*

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[3] The SEC's comments on its rules were published in 76 *Fed. Reg.* at 34350 (2011) (emphasis added), and are *available at* https://www.kkc.com/assets/site_18/files/sec/sec78u-6.pdf.

[4] *Id.*

[5] *Id.*

reports misconduct by another person and it would be contrary to public policy for whistleblowers to benefit from their own misconduct."[6]

Since enacting this rule there have been no reported cases where a culpable whistleblower has been paid a reward based on his or her own misconduct, nor have there been any reports that the current rule is not working. All SEC-issued reward decisions are subject to review by the SEC Commissioners, which is a bi-partisan group of regulators. No Commissioner has issued a dissenting opinion complaining about an abuse of this rule, or that a culpable whistleblower profited from his or her own misconduct.

Instead, the Commission has praised the entire whistleblower program (which has already recovered nearly $1 billion for damaged investors and taxpayers) and stated, on the record, that the program is working well. *See* Part I.

If the program is not broken, why break it?

III. THE SEC HAS OTHER RULES PROHIBITING CULPABLE WHISTLEBLOWERS FROM OBTAINING A REWARD.

In addition to the explicit prohibition on culpable whistleblowers outlined above, the Commission has other rules that either prohibit, completely bar, or discourage truly culpable whistleblowers from profiting from their own frauds.

The first such rule is § 240.21F–15 which states that whistleblowers are not granted "amnesty" when they report violations. In other words, a whistleblower can be arrested based on the information he or she reports through the Dodd-Frank Act's whistleblower program. This is a strong discouragement, aimed precisely at persons truly culpable for the misconduct. It is difficult to image that a person who planned and initiated a fraud would then turn in that very fraud, knowing that he or she could be indicted for the very conduct reported.

The second prohibition, reflected in both the SEC rules and the underlying statute, prohibits (without exception) individuals who are convicted of a criminal violation, related to any law for which a reward could be paid, to obtain a reward. 15 U.S.C. § 76u-6(c)(2)(B). The False Claims Act contains a similar prohibition.

A third prohibition prohibits the payment of a reward to any whistleblower who obtained his or her information "by a means or in a manner that is determined by a United States court to violate applicable Federal or state criminal law." § 240.21F-4((b)(4)(iv). If you violate a law (i.e. initiate a fraud) to obtain information about the fraud, you cannot collect a reward.

A fourth prohibition concerns how the Commission sets the amount of a reward. The SEC may take into consideration an employee's "culpability" when accessing the amount of a reward, even if the individual is not convicted of a criminal offense, and even if the individual was simply a minor participant in a fraud. § 240.21F-6(b)(1).

Finally, SEC regulations permit the Commission to deny a reward to anyone who "knowingly or willfully" makes "any false, fictitious, or fraudulent statement or representation" or who

[6] *Id.*

"otherwise" acts to "hinder the Commission or another authority." § 240.21F-8(c)(7). In other words, if a whistleblower lies about his or her own culpability, that individual can be denied a reward, even if otherwise he or she would be fully eligible.

In approving these rules governing its whistleblower program, the SEC created numerous checks on unethical individuals who would attempt to profit from their own misconduct, or lie to the Commission about their culpability.

IV. THE "DUTY TO PREVENT" REQUIREMENT IS A RADICAL DEPARTURE FROM ALL FEDERAL WHISTLEBLOWER LAWS AND WOULD UNDERMINE WHISTLEBLOWER PROTECTIONS.

Section 823 contains a "duty to prevent" violations. This requirement creates a near-impossible burden on employee-whistleblowers by requiring them to first report suspected violations internally. It is well documented that simply trying to report a violation up the chain-of-command is extremely difficult, and can result in retaliation. Significantly, under the current law numerous whistleblowers have experienced retaliation for internally reporting violations to their supervisors or a company's internal compliance program. Various courts, including the United States Court of Appeals for the Fifth Circuit, have ruled that whistleblowers who report concerns internally are *not protected* under the SEA's anti-retaliation law. In other words, under this interpretation of the SEA (which the entire Wall Street community has embraced), a whistleblower who tries to prevent a violation from taking place within a company can be fired, and will have no protection under the SEA.

Moreover, mandating a "duty to prevent" would undermine the Sarbanes-Oxley Act's provision that guarantees confidentiality to internal whistleblowers who report violations to a company's audit committee. Under SOX, employees have a right to make these reports confidentially. But forcing employees to actively try to "prevent" a violation would effectively destroy the ability of employees to maintain confidentiality. The employer would know who tried to "prevent" the fraud, and this would effectively identify who the whistleblower was. This would be especially true if the employee was required not simply to object to the illegal practice, but actually required to takes steps to "prevent" the illegal conduct. Clearly, the more prudent path would be to report the crimes to the appropriate law enforcement authority, instead of trying to take the law into one's own hands.

Of the nearly 60 whistleblower laws enacted by Congress since 1970, *none* of these laws have a "duty to prevent." The fact that Congress has never added a mandatory "duty to prevent" to any of the scores of whistleblower laws, including those covering miner safety, airline safety, government fraud and abuse, nuclear safety, transportation safety etc., speaks for itself that such a provision is both unnecessary and potentially destructive of the goal to encourage reporting.

V. THE REASONS WHY THE SEC WHISTLEBLOWER PROGRAM WORKS ARE SCIENTIFICALLY AND EMPIRICALLY DEMONSTRABLE.

The underlying reasons for the SEC program's success are well established. In January 2017, the University of Toronto's Rotman School of Management held a conference focusing on fraud detection within publicly traded companies. The conference covered essential information necessary to understand how whistleblowing works in practice, and why laws such as the False

Claims Act and the SEC's whistleblower program are remarkably successful. The full summary of the conference and supporting materials is available online at bit.ly/UTorontoSeminar, and we strongly encourage all Members of this Committee to review these scholarly proceedings before taking any action which may undercut the SEC's whistleblower program.

University of Toronto Professor Alexander Dyck chaired the conference at the University of Toronto. Professor Dyck serves as the Manulife Financial Chair in Financial Services, Professor of Finance and Business Economics, Rotman School of Management and Director, Capital Markets Institute. He is a world-renowned expert on fraud detection methodology, and was the principle author in the key study on the impact of whistleblowing on fraud detection. His research on fraud detection (which included studying reporting behaviors under the False Claims Act), originally published in 2008 by the University of Chicago Booth School of Business, is the seminal work on this subject and should be carefully studied.[7] *See* "Who Blows the Whistle on Corporate Fraud?" (Alexander Dyck, University of Toronto; Adair Morse, University of California, Berkeley and Luigi Zingales, University of Chicago).

Among his critical findings are:

- "Employees clearly have the best access to information. Few, if any, fraud can be committed without the knowledge and often the support of several of them."
- "[I]n 82 percent of cases, the whistleblower was fired, quit under duress, or had significantly altered responsibilities. In addition, many employee whistleblowers report having to move to another industry and often to another town to escape personal harassment. . . . Given these costs, however, the surprising part is not that most employees do not talk; it is that some talk at all."
- "Monetary incentives seem to work well, without the negative side effects often attributed to them."

Professor Dyck's study focused on how to get those with the best information about fraud to report the misconduct. Professor Dyck and his co-authors pointed out the positive role that rewards can play in promoting accountability and exposing frauds:

> *A natural implication of our findings is that the use of monetary rewards providing positive incentives for whistle blowing is the possibility of expanding the role for monetary incentives. As the evidence in the healthcare industry shows, such a system appears to be able to be fashioned in a way that does not lead to an excessive amount of frivolous suits. The idea of extending the qui tam statute[8] . . . is very much in the Hayekian spirit of sharpening the incentives of those who are endowed with information.*

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[7] Linked in the conference proceedings, *available at*: http://www.rotman.utoronto.ca/FacultyAndResearch/ResearchCentres/CapitalMarketsInstitute/Events/PastEvents/Whistleblowers.

[8] The term "*qui tam*" refers to the provision within the False Claims Act that permits employees to obtain a financial reward if their original information results in a successful enforcement action. The reward is paid directly from the monies obtained from the wrongdoer, at no expense to the taxpayers.

Another presenter at the University of Toronto conference was Andrew Call, an Associate Professor at the W.P. Carey School of Business at Arizona State University.[9] He presented findings from his study concerning the impact whistleblowers have on the quality of government investigations. *See,* Call, et al., "Whistleblowers and Outcomes of Financial Misrepresentation Enforcement Acts," *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2506418. His findings scientifically demonstrate that if a whistleblower comes forward with evidence of fraud, the probability of a successful investigation and prosecution is enhanced, and the likelihood of a guilty finding is increased. His findings provide additional scientific proof supporting Professor Dyck's work, which objectively demonstrates that whistleblowing serves the public interest and must be enhanced and incentivized.

Peter Dent, Partner, Deloitte, LLP, also presented at the University of Toronto conference. Mr. Dent provided expert analysis of the difficulties employees face when they expose wrongdoing. Mr. Dent discussed another objective, scholarly report on how whistleblowers are perceived at work. Aptly titled "Nobody Like's a Rat," this study, published by the Columbia University Journal of Economic Behavior and Organization, explained how whistleblowers are shunned and subjected to retaliation and blacklisting—which ultimately disincentivizes others from reporting fraud in their organizations.

The report's findings are most troubling, as it concluded that even organizations that are composed of honest persons will shun a whistleblower who reports dishonest behavior:

> **However, we also find that when groups can select their members, individuals who report lies are generally shunned, even by groups where lying is absent. This facilitates the formation of dishonest groups where lying is prevalent and reporting is nonexistent.**[10]

Taken together, the three studies presented at the conference objectively demonstrate, with empirical evidence, that (a) whistleblowing is the key to fraud detection; (b) whistleblowers help trigger better government investigations with stronger enforcement outcomes; and that (c) whistleblowers will suffer retaliation and blacklisting, and thus badly need strong protections and incentives.

These studies help explain why the current SEC program has been highly effective: The program incentivizes those with inside information to report, and therefore engenders a strong fraud detection program. The sources of information are well-placed and help the government target its investigations into serious frauds for which solid evidence of wrongdoing can be obtained (with help from the "insider"). Finally, by permitting whistleblower to proceed confidentially and anonymously the SEC program provides the single best protection against retaliation – the SEC does not identify the whistleblower, or the fact that there even is a whistleblower, to the company, and thus the company cannot retaliate.

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[9] *See,* footnote 5.

[10] *See* "Nobody likes a rat: On the willingness to report lies and the consequences thereof." (Ernesto Reuben, Matt Stephenson, Columbia Business School) (emphasis added), *available at*: http://www.sciencedirect.com/science/article/pii/S0167268113000735.

The Committee should strongly support the current SEC whistleblower program, ensure that it has all of the resources necessary to thrive, and oppose any attempt to weaken its provisions. Section 823 should be struck from the Discussion Draft and not included in any bill reported by the Committee.

Thank you for your time and consideration.