TESTIMONY TO THE MARYLAND FINANCIAL CONSUMER PROTECTION COMMISSION
December 5, 2017

Thank you for the opportunity to address this Commission today. I'm honored to address the members of the Maryland General Assembly who are part of this Commission, our Commissioner of Financial Regulation, our Attorney General, County Officers and members of the public and representatives of financial institutions here in Maryland. I would also like to recognize your Commission Chairman Gary Gensler, someone I had the pleasure of working with in the federal government, as well as a former Treasury colleague, Mark Kaufman.

In the course of my career I had the privilege of two extraordinary jobs in the private and public sectors. I spent 26 years at T. Rowe Price's headquarters here in Maryland. The company is a leader in mutual fund and 401K retirement assets, which is very relevant to your focus on consumer finance. My time at T. Rowe Price included 10 years managing the Maryland Bond Fund, the single largest investor in Maryland state and local government debt.

In 2009 I was asked to join the U.S. Treasury at a very pivotal moment. We were still recovering from the financial crisis and the aftermath of a deep recession. We were contemplating the largest regulatory reform of our financial system since the 1930's. I spent the next five years managing our public debt, overseeing implementation of many aspects of the Dodd Frank legislation, and working on a number of projects to help consumers achieve more savings, better credit and financial outcomes.

At T. Rowe Price I worked for the shareholders of the mutual funds and the owners of a large asset management company. At the Treasury I worked for the taxpayers of the world's largest economy. These two experiences gave me an unusual opportunity to look at how the financial system affects the real economy, from the largest players to the individual consumer. What was clear to me in 2009 was that we had an outdated regulatory system that had not kept up with the evolution of the financial markets. In short, financial reform was not an option, but a critical necessity.

I've read the testimony from your October hearing and I'm not going to either rehash the features of the financial crisis or work through each title of the Dodd Frank legislation. I think you have that background already. Instead I would like to push the discussion forward by providing some broad thoughts about the new administration and their approach to financial regulation. In doing so, I would like to highlight a few areas where I think the State could be proactive in advancing both consumer protections and access to the financial system.

Financial Regulation at the Federal Level

One narrative in the public domain is that the Obama Administration regulated and the Trump Administration will now deregulate. I think that is far too simplistic a view. It misses the major accomplishments of financial regulation to date and doesn't offer much hope for influencing outcomes from here, which I believe is both important and possible.

First, I don't think that anyone disputes that we need financial regulation. As the CEO of one large financial institution used to say to me, "I want to live in a good neighborhood. I won't succeed if others are pulling the whole industry down." I recall trying to explain financial regulation to the students at my sons' high school and using the FAA as an example. I don't think anyone wants to fly in unregulated air space and the same is true of the superhighway of our financial system. We need speed limits and guard rails to protect large and small actors in the financial system.

The key is getting the balance right and understanding the tradeoffs. As I learned working on policy matters in the government, the issues are always complicated and the various constituencies even more so. Making financial institutions safer and more liquid almost always means reducing opportunities for greater profit and risk taking. Making products safer for consumers almost always means reducing access to credit. You are constantly in the position of deciding whether the dislocations and disruptions of change are worth it. As they say, the devil is in the details and getting the right balance, drawing the lines in the right places is the hard work of financial regulation.

So what has been happening this year? In February the Trump Administration published seven principles for financial reform:[1]

- Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
- Prevent taxpayer-funded bailouts;
- Foster economic growth and vibrant markets through more rigorous regulatory impact analysis that address systemic risk and market failures, such as moral hazard and information asymmetry;
- Enable American companies to be competitive with foreign firms in domestic and foreign markets;
- Advance American interests in international financial regulatory negotiations and meetings;
- Make regulation efficient, effective and appropriately tailored; and

[1] Executive Order 13772 (Feb. 3, 2017). Core Principles for Regulating the United States Financial System. https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

- Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

It would be hard to argue with these principles, which are largely in alignment with the prior administration. However, the principles were used to direct the Treasury to produce four reports with recommendations for further financial reforms. Three have been published - on the banking system and credit unions, on capital markets, and one on asset managers and insurers.[2] Still to come is a final report on non-bank financial institutions, financial technology and innovation, and separate reports on living wills (the provisions for orderly liquidation of large financial institutions - OLA) and a review of the new council of financial regulators – the Financial Stability Oversight Council or FSOC – and its powers to designate non-banks and financial market utilities for heightened supervision and enhanced prudential standards.

I've read the published reports and am struck by several things: First, that there aren't many new areas of focus for this Administration. They are largely reacting to existing issues in the market that were the same things the Obama Administration was focused on. The watch words of these reports, however, are often around things like calibration, harmonization, efficiency and

[2] U.S. Department of the Treasury. Core Principles Reports. https://www.treasury.gov/initiatives/core/Pages/default.aspx

cost/benefit analysis. In many cases the effect would be to weaken recent regulations, although in some cases the effect would be to clarify or simplify regulation.

Second, over the course of three reports there are a diminishing number of recommendations for legislative action. In the first report, with nearly 100 specific recommendations, about 35% required Congress to act. In the second report on capital markets about 10% of the 91 recommendations called for legislation, and in the most recent report on asset managers and insurers, only 4 of the 61 recommendations called for legislation. While this may be related to the different subject matter, there appears to be a growing realization that Dodd Frank is not going to be repealed and that the thrust will be to find areas of common ground for smaller legislative action and to focus the bulk of efforts on regulatory actions. This means there is an even greater need for vigilance in understanding those actions.

Having said that, I note that since your October hearing the Senate Banking Committee is considering a bill with bipartisan support to raise the asset thresholds for banks subject to heightened financial supervision from $50 billion to $250 billion, and to reduce certain regulatory requirements for many community banks and credit unions, particularly in the area of mortgage lending.[3]

[3] U.S. Senate. Committee on Banking Housing and Urban Affairs. S. 2155, The Economic Growth, Regulatory Relief, and Consumer Protection Act. https://www.congress.gov/bill/115th-congress/senate-bill/2155/all-info?r=1

Third, and perhaps most important, when you set aside the rhetoric there is no attempt to get rid of things like higher capital standards, stress tests and liquidity requirements for large banks, or new standards for trading and clearing in derivatives markets. Many of the proposals to reduce regulation are aimed at small banks with less complex business models. Instead of dismantling the FSOC, the new Administration wants to strengthen its powers to coordinate regulation. As for the Volcker Rule, there is a clear statement of support for the rule's intent to prohibit large institutions that benefit from federal deposit insurance from proprietary trading for their own account in ways that can put taxpayers at risk.

As for asset managers and insurance companies, the Trump Administration lands in the same place as the Obama Administration in one respect: from a systemic risk perspective, it is more critical to monitor the collective activities and products of asset managers than the financial position of individual companies. As agents of their clients' money, the asset managers themselves do not carry much balance sheet risk, but the size and scale of their investment activities can clearly present risk to the financial markets.

These perspectives do not mean there is no cause for concerns. One area of great importance to consumers is the so-called fiduciary rule. The fiduciary rule released by the Department of

Labor in April of 2016 represented over six years of work to modernize the rules affecting retirement savings to protect consumers.[4] It recognizes several important marketplace developments: the growth of self directed retirement accounts such as IRAs and 401(k) accounts over the past forty years (alongside the sharp reduction in company sponsored pension plans) as well as the migration of traditional broker dealers into the financial advisory role of fee based management of client accounts.

It is definitely time to level the playing field between asset managers who are fiduciaries under the Investment Company Act, and broker dealers who have historically worked under a lighter standard of suitability in making investment recommendations for their clients. It's also time for investors to have clear insight into the financial products and fees that are key to meeting their financial goals and to make sure their financial advisors are working in their clients' best interests.

So far the Trump Administration has adopted the definition of a fiduciary that cements the concept of an advisor working in the best interest of their client – which I think is quite important - but has delayed the implementation of compliance with many aspects of the rule until July 2019 while seeking further input.

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[4] U.S. Department of Labor. Conflicts of Interest Final Rule. https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2

The SEC has since announced that it will be developing it's own definition of a fiduciary standard that would have broader coverage of the market for both retirement and non-retirement financial investments.[5] Delaying adoption of areas of the DOL's fiduciary rule appears designed to allow the SEC to take the lead on this issue.

The Treasury's report on asset management and insurance calls for collaboration between the SEC, DOL and the states in developing this fiduciary standard. In one case the State of Nevada has actually developed its own standard. I urge you to stay close to these developments for the benefit of the citizens and consumers who will ultimately be the most affected by the final outcome here.

Finally, we still need to see the Treasury's fourth report on financial technology and innovation. Financial accidents often occur in areas outside the so-called regulatory perimeter. For example, this year's explosion in the value of bitcoin and other crypto currencies is bringing an obscure area of finance into the mainstream. When retail investors start chasing an investment fad, regulators should begin to take notice. Similarly, on line lending can provide credit access to borrowers who aren't being served by the traditional banking system, but can also introduce risks.

[5] U.S. Securities and Exchange Commission. Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers. June 1, 2017. https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31

On a more practical note, I think that many of the financial technology innovations in payment systems, blockchain technology, and digital platforms are welcome improvements to the back office systems of our financial system. The use of technology to create more efficient ways for small investors to manage their assets is also revolutionizing the way financial advisors can work with clients.

To summarize my thinking about the new Administration's approach to financial regulation, I do not see the potential for wholesale repeal of important safeguards of our complex financial system that were advanced by the prior Administration. I do see areas of common ground where there is general support for revisiting certain rules to see if they can be better calibrated to the size and complexity of financial institutions and if there are ways to improve access to credit without undue risk. Nevertheless, there are reasons to be vigilant where change means moving back toward an undesirable lack of protection.

Areas for Maryland to Take Action

So far I have focused on financial developments at the federal level. This should in no way ignore the ways that Maryland can advance improvements in the financial system for its own residents. I would like to recognize the important legislation passed last year to create the Maryland Small Business Retirement Savings Program and Trust.[6]

I don't need to tell you that we face a retirement savings crisis in this country, with a third of working Americans saving nothing for retirement. In Maryland it is estimated that as many as one million employees are working full time without a retirement savings plan.[7]

My experience in the asset management industry showed me the value of automatic savings through payroll deduction. Many companies now require automatic enrollment in 401(k) retirement plans that allow employees to opt out – in fact, about 90% stay enrolled and build meaningful savings.

Maryland, along with eight other states, are creating plans that allow workers without access to an employer sponsored retirement plan to begin saving on their own through payroll deduction. The same automatic enrollment feature would apply, with employees allowed to opt out. The State can enable this savings program by helping to select investment options from the private sector and making it easy for businesses and their employees to participate.

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6 Maryland House Bill 1378. An Act concerning Maryland Small Business Retirement Savings Program and Trust. Approved by the Governor on May 10, 2016. http://mgaleg.maryland.gov/2016RS/chapters_noln/Ch_324_hb1378E.pdf

7 1,000,000 of Our Neighbors at Risk: Improving Retirement Security for Marylanders. https://www.brookings.edu/wp-content/uploads/2016/06/improving_retirement_security_maryland.pdf

Programs like this begin to solve a market failure, where small businesses do not have the resources to offer a retirement plan, and the financial industry isn't serving small savers. By creating an easy way for small businesses to offer savings accounts that are managed by the private sector, the State can help close this gap.

While at the U.S. Treasury I helped roll out a similar program called myRA, an individual savings account built on the IRA model to allow small savers without access to a retirement savings plan to use payroll deduction to invest in a principal protected Treasury savings bond. Once the account reached $15,000 it had to roll over to a private sector firm. One area of great disappointment for me was the Treasury's decision earlier this year to end the myRA program, citing insufficient demand. The related decision by the Trump Administration to not allow States to offer myRA as an option in State based savings plans directly contributed to the program's demise. The need to solve this critical savings issue is now squarely back in the States' domain.

I have followed actions in other states to enable these programs, in particular the OregonSaves Program and California's Secure Choice Retirement Savings Program. I encourage Maryland to move forward with setting up its program and to learn from the early experience of other states that are launching these programs.

A second area where the State could be helpful is in enabling more small business lending. Recently I led a study at Johns Hopkins University of Baltimore City's financial capacity to support the growth of small companies.[8] The data show that lending capacity has diminished with bank consolidation, the loss of locally headquartered banks, and a shift away from working capital loans towards real estate lending.

We identified approximately 20 State run programs that are geared toward small business lending or investment, as well as a number of narrowly targeted tax credits for small companies. In some cases the programs, such as the Maryland Industrial Development Finance Authority are underutilized and hard to navigate. In total, looking back ten years, the public sector dollars devoted to direct lending are pretty small. We recommended reviewing these programs to see if these funds could be leveraged more effectively to grow working capital loans. The same amount of dollars secured in a revolving loan loss reserve fund could leverage multiple dollars in private sector lending.

We also highlighted the need to rebuild the art and practice of small business lending to recognize technological and credit model innovations in lending. Specific recommendations included convening a small business lending summit on these ideas,

[8] Johns Hopkins University. Financing Baltimore's Growth: Measuring Small Companies' Access to Capital. Sept. 2017. http://21cc.jhu.edu/wp-content/uploads/2017/09/21cc-financing-baltimores-growth-sept-2017.pdf

developing more lenders skilled in executing federal SBA loans to small businesses, and building the capacity of local Community Development Financial Institutions to close the gaps when private lender credit is unavailable. While not strictly a consumer finance issue, supplying more credit to fuel entrepreneurs and Main Street businesses could go a long way towards helping the real economy in Maryland.

Thank you very much for the opportunity to appear before you today.