Testimony of Stephen W. Hall

Legal Director and Securities Specialist

For

Better Markets, Inc.

Before

The Maryland Financial Consumer Protection Commission

On

Financial De-Regulation at the Federal Level

At

The Miller Senate Office Building

Annapolis, Maryland

Thursday, October 26, 2017

INTRODUCTION

Chairman Gensler and Members of the Commission, it's a privilege to testify on behalf of Better Markets at this important hearing. We're a nonprofit, nonpartisan organization based in Washington, DC, that was founded in the wake of the 2008 financial crisis. Our mission is to fight for a financial system that is less prone to crisis and more fair to consumers. Ultimately we seek to promote the economic security and prosperity of all Americans and to prevent those priorities from being subordinated to the profit and bonus-driven culture that pervades Wall Street. Over the past seven years, we have submitted hundreds of comment letters to the financial regulators, participated in dozens of court cases as an amicus or a principal party, prepared numerous in-depth studies, and advocated for financial reform through all forms of mainstream and social media. All of our advocacy is collected on our website at www.bettermarkets.com.

My basic point today is this: We are in the early stages of a major wave of financial de-regulation that will, without question, increase the likelihood and severity of another financial crisis and once again inflict devastating losses on millions of everyday Americans in Maryland and across the country. This de-regulatory movement will also expose investors and consumers to much more fraud and abuse and rob them of meaningful ways to hold financial firms accountable. We must fight against this deeply misguided ideology using all the tools and alliances at our disposal.

In my testimony, I'd like to address five subtopics all related to the primary subject of de-regulation at the federal level:

- The reasons why the deregulatory movement now underway is such a dangerous threat;
- The principal myths underlying de-regulation;
- The prevalent strategies of de-regulation;
- Some specific threats to federal financial regulation that will be especially damaging; and
- A brief overview of some methods for combatting this trend.

Before digging in to those topics, I'll offer three preliminary observations.

First, the establishment of this Commission is an appropriate and timely step. The states have a critically important role to play in counteracting federal deregulation to protect consumers, whether it's through enhanced enforcement or the adoption of state laws and rules to compensate for emerging gaps at the federal level. A state-level body such as the Commission dedicated to understanding the threat is a critical step in the process.

Second, I know firsthand how effective the states can be in the realm of financial regulation. I had the privilege of serving as the Deputy General Counsel for the association of state securities regulators, known as NASAA. During my tenure from 2001 to 2009, I witnessed states such as New York and Massachusetts, along with Maryland and the entire NASAA membership, take landmark enforcement actions against egregious frauds committed by Wall Street research analysts, mutual fund companies, and others—all while the SEC stayed largely on the sidelines. It was a remarkable display of the states filling an enforcement void at the federal level.

Finally, I'd like to suggest that today's hearing raises the possibility of a new partnership between advocacy organizations like Better Markets and the states. While we can share our expertise about the federal regulatory landscape and the current trends, we also need to learn more from you: What are the strategies at the state level that might be applied to help protect the public from the Wall Street recklessness that triggered the last financial crisis and the fraud, abuse, and conflicts of interest that continue to bleed away untold amounts of Americans' hard-earned money.

1. WHY DEREGULATION IS SUCH A GRAVE THREAT

There are very few events that can do more to destroy the quality of life for Americans than a financial crisis. Yet that is what we are facing if the pendulum swings back in the direction of de-regulation.

A. The 2008 Crisis

Beginning in the fall of 2008, just nine years ago, the worst financial crisis since the Great Crash of 1929 swept over our country. The costs have been monumental in economic and human terms, and they are still being felt. Conservative estimates show that the crisis destroyed at least $20 trillion in gross domestic product.[1] And in terms of real-world human suffering, it threw millions of Americans into long-term unemployment and underemployment, cast over 15 million homes into foreclosure, and obliterated $19 trillion in wealth, including retirement savings.[2]

B. The response

Congress and the President responded by enacting the Dodd-Frank Act, signed on July 21, 2010, with sweeping reforms aimed at stabilizing our financial system, preventing taxpayer bailouts of the too-big-to-fail banks, and establishing new consumer protections in the financial services arena. Its major provisions include—

- Establishing new capital, liquidity, leverage, and stress testing requirements to fortify our banking system against stresses that could trigger another financial crisis;

- Establishing the Financial Stability Oversight Council (FSOC) to identify threats to financial stability among **nonbank** financial institutions and to designate those institutions for enhanced supervision by the Federal Reserve;

- Establishing an entirely new and comprehensive regulatory framework for the derivatives known as swaps, including trading on designated platforms, clearing of swaps

---

1 Better Markets, The Cost of Crisis, $20 Trillion and Counting (July, 2015), https://www.bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

2 *Id.*

transactions, reporting of swaps trading data, and setting margin and capital requirements on swaps transactions;

- Establishing new consumer protections by setting up the Consumer Financial Protection Bureau (CFPB) to police fraud in the sale of financial products and services and by authorizing the SEC to enhance investor protections with a new fiduciary standard for advisers, limits on mandatory arbitration, and better incentives and anti-retaliation protections for whistleblowers.

All of these reforms were inspired by a renewed and painfully-acquired understanding that Wall Street should serve the needs of the real economy and everyday Americans, not simply feed off the American economy by engaging in high-risk activities that boost profits but ultimately threaten catastrophic down turns and tax-payer funded bailouts.

C. De-regulation and the threats it poses

Now, with the installation of the new Administration in January, we are confronting a new wave of financial de-regulation. As described in more detail below, the de-regulatory effort is taking many forms, from attempts in the so-called CHOICE Act to dramatically overhaul Dodd-Frank, to a series of executive orders, rule proposals, and agency guidance documents focused on eliminating existing rules and crippling the agencies' ability to adopt new rules. While none of the more eye-catching legislative measures have yet to arrive at the President's desk, make no mistake: Largely at the agency level if not on the Hill, a host of beneficial regulations will be killed, weakened, or delayed, and many other rules we need to put in place will never see the light of day. In short, and at a minimum, de-regulation will eat away at our financial rules like a colony of termites destroying an entire structure in small increments.

The threat of harm is clear. If unchecked, de-regulation will inevitably lead to another financial crisis, possibly even more severe than the one we've just endured. That means the destruction once again of the very things that Wall Street and their allies in the Administration and Congress profess to care so much about: jobs, housing, secure retirements, economic growth, and overall prosperity. Another crisis would be especially hard on the states, since recent reports indicate that many are unprepared for even a moderate economic downturn that decreases revenues and spikes demand for services.[3] The rollback of consumer protections will also mean more painful losses for millions of Americans, from retirees who fall prey to adviser conflicts of interest, to low income workers who can least afford the trap of a payday loan at crushing interest rates.

The truth is, we need strong rules of the road, strong enforcement of those rules, and strong regulatory agencies properly funded and staffed with dedicated public servants to create

---

[3] Sharon Nunn, *Most States Aren't Prepared for the Next Recession*, Wall St. J., Oct. 18, 2107, https://blogs.wsj.com/economics/2017/10/18/most-u-s-states-arent-prepared-for-the-next-recession/.

and maintain the conditions necessary for lasting economic prosperity that all Americans can enjoy.

Many authoritative voices have spoken out in opposition to deregulation of our financial institutions and markets. As Fed Vice Chair Stanley Fischer said in responding to calls for looser capital and liquidity requirements on banks:

> I am worried that the US political system may be taking us in a direction that is very dangerous . . . . It took almost 80 years after 1930 to have another financial crisis that could have been of that magnitude. And now, after 10 years everybody wants to go back to a status quo before the great financial crisis. And I find that really, extremely dangerous and extremely short-sighted.[4]

A New York Times editorial tied these concerns specifically to the need for **more** oversight and transparency in the financial markets, not less:

> De-regulation led to the financial crash of 2008. It's safe to assume that repeating the mistake will lead to the same result. . . . [W]ithout continued bank regulation, and heightened vigilance of derivatives, in particular, the good fortune of bank investors and bank executives is all too likely to come at the expense of most Americans, who do not share in bank profits but suffer severe and often irreversible setbacks when deregulation leads to a bust.[5]

Protecting and preserving regulation will take concerted action by many different groups and constituencies, and the states have a critical role to play in influencing the federal agencies who will peel back the rules and the courts that will be the last hope for preserving reform.

2. TWO MYTHS UNDERLYING THE DE-REGULATORY MOVEMENT

The financial services industry is powerful and well-funded, and it is very adept at crafting arguments to support de-regulation, whether it's the repeal of the Dodd-Frank Act or other commonsense rules designed to protect the public. In reality, though, their arguments have little basis.

A. The myth that regulation is stifling economic growth

The most prominent myth advanced by the financial services industry is the claim that regulation is overly burdensome and is stifling our markets and our overall economic prosperity. In fact, the data show just the opposite. Financial regulation has created the conditions for a sustained period of economic growth and prosperity, just as the securities laws did following the crash of 1929. Many prominent policy makers and market watchers have recently highlighted the ever-increasing profits in the financial sector, the presence of healthy liquidity levels in our markets, and the overall strengths of our economy.

---

4 Abhinav Ramnarayan, *Fed's Fischer Says Move to Unwind Bank Regulation 'Dangerous*,' Reuters (Aug. 17, 2017), https://www.reuters.com/article/us-usa-fed-fischer-idUSKCN1AX0PK.

5 R. M. Schneiderman, *Did Deregulation Cause the Credit Crisis?*, NEW YORK TIMES (Oct. 8, 2008), https://economix.blogs.nytimes.com/2008/10/08/did-deregulation-cause-the-credit-crisis/?mcubz=0.

For example, the FDIC reported that the financial sector is seeing record profits, the rate of loan growth for the industry remains above the growth rate of GDP, and loan balances for community banks are up a robust 7.7 percent year-over-year.[6] The FDIC Chairman reviewed this data in recent testimony before the Senate Banking Committee and noted that "annual increases in industry net income have averaged 7.8 percent per year since 2011. FDIC-insured institutions reported a record $171.3 billion in net income in 2016, marking a net increase of 44 percent over the past five years."[7]

The American Banker, a trade publication, also reviewed the evidence and concluded:

> Republicans have repeatedly asserted that the 2010 financial reform law has increased the cost of consumer lending and cut off access to credit. . . . Yet the available data indicates otherwise. Consumer credit has roared back in the six years since Dodd-Frank, with a 46% jump in outstanding consumer credit to $3.8 trillion. . . . **[T]he fact remains that mortgage, auto and credit card lending have all gone up since 2010**. [Mortgage] lending standards are as loose as they've been since the downturn. . . . Auto lending has been on a tear since the financial crisis . . . . Credit card lending has returned to pre-crisis levels with total lending hitting an all-time high of $996 billion. . . .[8]

And Bloomberg reached a similar conclusion:

> Lending declined initially after 2008, when the entire banking industry was almost wiped out by the collapse of the U.S. housing market. But it's grown steadily since then, expanding by 6 percent a year since 2013, far faster than the economy. Banks now have a record $9.1 trillion of loans outstanding.[9]

Federal Reserve Board Chair Janet Yellen testified before the Senate Banking Committee that commercial and industrial lending has surged in recent years, along with industry profits:

> There's much more capital in the banking system. U.S. banks are generally considered quite strong, relative to their [international] counterparts. They built up capital quickly, partly as a result of our insistence that they do so, following the financial crisis. . . They're gaining market share and they remain quite profitable.[10]

---

6 Federal Deposit Insurance Corporation, Quarterly Banking Profile: First Quarter 2017, https://www.fdic.gov/bank/analytical/qbp/2017mar/qbp.pdf.

7 Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, on Fostering Economic Growth: Regulator Perspective before the Committee on Banking, Housing, and Urban Affairs, United States Senate, June 22, 2017, https://www.fdic.gov/news/news/speeches/spjun2217.pdf.

8 Kate Berry, *Four Myths in the Battle over Dodd-Frank*, American Banker, March 10, 2017, https://www.americanbanker.com/news/four-myths-in-the-battle-over-dodd-frank (emphasis added).

9 Zeke Faux, Yalman Onaran, and Jennifer Surane, *Trump Cites Friends to Say Banks Aren't Making Loans. They Are*, Bloomberg, Feb. 4, 2017, https://www.bloomberg.com/news/articles/2017-02-04/trump-cites-friends-to-say-banks-aren-t-making-loans-they-are (emphasis added).

10 Jeff Cox., *Yellen: Trump is completely wrong that banks aren't lending*, CNBC, Feb. 14, 2017, http://www.cnbc.com/2017/02/14/janet-yellen-banks-are-lending-and-quite-profitable.html.

Former Federal Reserve Board Chair Paul Volcker made similar observations in April 2017 in remarks to the Bretton Woods Committee:

> [C]laims that Dodd-Frank and other regulatory approaches have somehow gravely damaged the effective functioning of American financial markets, the commercial banking system, and prospects for economic growth simply do not comport with the mass of the evidence before us. Here we are in 2017 with a near fully employed economy, close to stable prices, bank profits at a new record, and the return on banking assets again exceeding one percent. Loans at both large and small banks are at new highs, double the pre-crisis years. In fact, loan growth has again been exceeding growth in nominal GDP.[11]

This data, gathered years after Dodd-Frank was passed and substantially implemented, provide real-time, real-life evidence that financial protection rules have not damaged the banks or the economy. Rather, they have created the conditions for sustained economic growth, broader prosperity, and reduced inequality, which, if the financial protection rules are allowed to continue working, should become durable and sustainable.

B. The myth that investors and consumers actually suffer from regulation

Also common among proponents of de-regulation is the claim that investor and consumer protection rules actually hurt the very people they are intended to help by limiting choice, increasing the cost of financial products and services, and sowing confusion. Here too, the reality tells a different story.

A classic case in point is the Department of Labor's fiduciary duty rule. As explained below, this rule, if it survives numerous threats, will simply require advisers who recommend retirement investments to act in the best interest of their clients. Yet the centerpiece of the campaign against the rule mounted by brokers, banks, and insurance companies is the notion that the rule will actually choke off affordable advice to retirement savers, especially those with modest account balances. But the DOL thoroughly considered this and many other possible effects of the rule during the years-long rulemaking process and found them unpersuasive. Every court to consider the issue has agreed with the DOL. And most compelling is the actual evidence of the impact of the rule since it was finalized in April of 2016. In response to the rule, the industry is adapting in ways that are actually decreasing costs to retirement savers, who continue to have ample access to affordable advice.[12]

---

[11] Remarks by Paul A. Volcker at the 2017 Annual Meeting of the Bretton Woods Committee, Apr. 19, 2017, https://www.volckeralliance.org/sites/default/files/attachments/Paul%20Volcker_Bretton%20Woods%20Speech_19Apr2017.pdf.

[12] The Consumer Federation of America submitted an August 7, 2017 comment letter to the DOL that exhaustively reviews the positive impact that the rule is having, which is available at http://consumerfed.org/wp-content/uploads/2017/08/cfa-response-to-dol-fiduciary-rule-rfi.pdf. In an encouraging sign, the Chairman of the SEC, when asked during a congressional hearing whether the DOL rule is impacting the industry, testified that the rule is spurring helpful innovation and that his agency has not come across evidence suggesting the industry is unable to comply with the DOL fiduciary rule. *See*

More generally, claims that financial regulation will harm consumers and investors have been proven false again and again. This pattern has been the hallmark of opposition to financial regulation for almost a century. It was played out with each new effort to strengthen financial regulation, including the federal securities laws, deposit insurance, the Glass-Steagall Act, mutual-fund reform, and others.[13] In each case, the imagined harm from regulation failed to materialize. Accordingly, the disingenuous arguments once again being advanced to repeal or fend off regulation must be discounted.

3. CORE STRATEGIES OF DE-REGULATION

The effort to unwind beneficial financial regulation is underway on multiple and coordinated fronts: in Congress, in the White House, in the regulatory agencies, and in the courts. Understanding the prevailing strategies can help identify where the resistance to de-regulation can best focus its efforts. Here is an overview of the types of de-regulatory devices that are being deployed.

A. In Congress

Major bills that would repeal broad swaths of regulation. These measures are like the wrecking balls of de-regulation and they pose the greatest threat in terms of scope. However, they also present challenges for their sponsors given their complexity and the many different rules they target simultaneously. The prime example is the CHOICE Act 2.0. It would, among other things, (1) repeal the Volcker rule; (2) repeal the orderly liquidation authority; (3) repeal the FSOC's designation authority; (4) require cost-benefit analysis for all rules; (5) require congressional approval of all major rules; (6) sharply reduce the CFPB's enforcement authority and subject its budget to the appropriations process; and (7) repeal the DOL's fiduciary duty rule.

Standalone bills that target specific rules or issues. Exemplifying this approach are the numerous bills introduced by Rep. Ann Wagner (MO) and others that would kill the DOL fiduciary duty rule. In addition, large collections of deregulatory bills sometimes wend their way through

---

Chairman Jay Clayton's October 4, 2017 testimony before the House Financial Services Committee, available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402349.

13 *See, e.g.*, Marcus Baram, *The Bankers Who Cried Wolf: Wall Street's History of Hyperbole About Regulation*, The Huffington Post, June 21, 2011, 6:56 PM, http://www.huffingtonpost.com/2011/06/21/wall-street-history-hyperbole-regulation_n_881775.html; Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & Econ. 229, 249 (2003) ("In the 5 years following adoption of [the most stringent type of blue sky law statute], bank profits increased on average by nearly 5 percentage points . . . ."); *see also* John Heltman, *Mortgage Rules Not Chilling Market as Feared, Data Shows*, American Banker, Sept. 24, 2015, http://www.americanbanker.com/news/law-regulation/mortgage-rules-not-chilling-market-as-feared-data-shows-1076899-1.html (belying claims that new mortgage underwriting standards would "cripple credit availability" and spur banks to "quit the business entirely"); Comment of Fin. Planning Coal., July 5, 2013 (application of fiduciary standard to fee-based accounts did not cause predicted "parade of horribles"), https://www.sec.gov/comments/4-606/4606-3126.pdf.

committee as a group. For example, on October 12, 2017, the House Financial Services Committee "passed 22 bills to ease regulations."[14]

Bills that would impose onerous new requirements on regulatory agencies. These measures seek to cripple the rulemaking process, not particular rules. Chief among them is the relentless effort to require all agencies to conduct an exhaustive and quantitative cost-benefit analysis before promulgating a rule, as provided in the CHOICE Act 2.0 and many other bills that have emerged over the years. Yet this impossible standard focuses the attention of regulators on the wrong question: What are the possible costs to a small handful of gigantic financial firms, as opposed to the real, often intangible, benefits of regulation to the American people? As Better Markets details in our report on the subject, costs are always easier to identify and quantify than benefits; while financial firms can easily point out a cost imposed by a given rule, the benefit of that same rule is often diffuse and identifiable only in the aggregate. Moreover, the process consumes scarce agency resources and sets up agency rules for ready challenges in court.[15] Fortunately, recent decisions from the D.C. Circuit have rejected rule challenges based on cost-benefit arguments, holding that the SEC and the CFTC are not bound to conduct such analyses since Congress did not require them to perform "rigorous, quantitative economic analysis."[16]

The Congressional Review Act (CRA). This powerful tool is essentially a legislative chainsaw for cutting down agency rules. It authorizes Congress to pass a joint resolution on a simple majority vote within 60 legislative days that disapproves or nullifies any "major rule" promulgated by an agency. Once signed by the President, the resolution bars the agency from adopting the same or any substantially similar rule without further Congressional authorization.[17] As further evidence of the staunchly de-regulatory bent of the Trump administration, the CRA was used successfully only once from its passage in 1996 until early 2017, but has been deployed over a dozen times since then to invalidate a host of regulatory protections adopted under the Obama administration. Especially painful from the state perspective was the CRA nullification of DOL rules that would have assisted states in setting up retirement savings vehicles for their private sector employees.[18]

---

14 Patrick Temple-West, House Financial Services passes 22 bills to ease regulations, PoliticoPro, Oct. 12, 2017, https://www.politicopro.com/financial-services/story/2017/10/house-financial-services-passes-22-bills-to-ease-regulations-163330.

15 Better Markets, Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC (July 30, 2012), http://www.bettermarkets.com/sites/default/files/documents/Setting%20The%20Record%20Straight.pdf

16 *Nat'l Ass'n of Mfrs. v. SEC,* 800 F.3d 518 (D.C. Cir. 2014); *Investment Co. Inst. v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013).

17 *See generally* 5 U.S.C. § 801-808.

18 House Passes Resolutions to Block State-Run Plans for Private Sector, ASPPA, Feb. 16, 2017, http://www.asppa.org/News/Article/ArticleID/7306/House-Passes-Resolutions-to-Block-State-Run-Plans-for-Private-Sector; Senate Votes to Block State-Run Private-Sector Retirement Plans, Bloomberg BNA, May 4, 2017, https://www.bna.com/senate-votes-block-n57982087536/.

B. <u>In the executive branch and in the agencies</u>

<u>The financial regulators.</u> The collection of federal agencies involved in financial regulation and their respective jurisdictions is complex. Attached as Addendum A is a chart summarizing the major players and their regulatory jurisdiction.

<u>Executive Orders.</u> President Trump has issued a series of executive orders and executive memoranda that call for the review of specific rules or impose new, general rulemaking requirements on agencies. Attached as Addendum B is a list of the most prominent ones issued to date. One of the most alarming examples is E.O. 13771, which requires agencies to eliminate two rules for every new rule adopted, regardless of the benefits provided by the rules proposed or rescinded.

<u>Studies.</u> President Trump has ordered a number of studies about financial regulation, some targeted and some very broad in scope. The Treasury Department has issued two major reports so far, in accordance with E.O. 13772, setting forth wide-ranging recommendations for de-regulatory financial reform.[19] The more recent one on "Capital Markets" contains dozens of de-regulatory suggestions that could be accomplished administratively without any further action by Congress.[20]

<u>Rules.</u> The basic rulemaking process under the Administrative Procedure Act[21] will be used both to repeal existing rules and to promulgate new ones that align with the Administration's minimalist view of regulation. Agency leaders often couch the effort to weaken rules in benign-sounding code words, describing the goal as merely to "simplify" or "harmonize" rules or to reduce the "unnecessary" burdens they impose on members of the industry. In theory, simplifying rules can be a positive step, but not when it actually denotes a process of stripping out important substantive protections in regulations.

<u>Guidance.</u> We expect frequent use of guidance by the agencies to effect de-regulation because guidance is generally subject to fewer procedural requirements. For example, traditional legislative rules are subject to the notice and comment rulemaking procedures set forth in the APA, and they are subject to judicial review in court under the deferential *Chevron* standard. However, interpretive guidance and statements of policy issued by an agency generally are not subject to those rulemaking oversight mechanisms.[22]

---

[19] U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Capital Markets, Oct. 2017, https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf; U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Banks and Credit Unions, June 2017, https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

[20] *See* U.S. Department of the Treasury, A Financial System that Creates Economic Opportunities: Capital Markets," https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[21] 5 U.S.C. §§ 500 *et seq.*

[22] *See Securities Industry & Financial Markets Ass'n v. Commodity Futures Trading Comm'n*, 67 F. Supp. 3d 373, 412 (D.D.C. 2014) (holding that the CFTC's cross-border guidance was not a legislative rule and therefore was not final agency action subject to judicial review); *see also* 5 U.S.C. § 553 (notice and

Weak enforcement. One of the most effective ways to effectuate de-regulation is to implement a weak enforcement program that fails to punish and deter violations of financial laws and regulations. Better Markets has long argued that enforcement on Wall Street is ineffective, but it promises to be even weaker going forward. The hallmarks of ineffective enforcement include (1) the habitual failure to name high level executives in enforcement actions; (2) imposing fines that are insignificant in relation to a bank's revenues and profits; (3) resolving cases with settlement agreements providing minimal disclosure of who committed the violations and the actual level of harm that resulted; (4) routinely waiving the regulatory disqualifications that banks are presumed to face under the securities laws when they violate the law; and (5) increased reliance on self-reporting, with credit for cooperation and to the exclusion of other robust enforcement measures.

Advisory Committees stacked with industry representatives. Federal regulators often empanel advisory committees to help the agencies gain deeper understanding of complex market or consumer issues and how regulation impacts various stakeholders. Unfortunately, these advisory committees are often stacked with industry insiders who simply aim to protect the status quo and advance their parochial interests as opposed to advising regulators on how best to advance what is in the public interest. One particularly egregious example is the SEC's Equity Market Structure Advisory Committee, or EMSAC. The SEC created this committee in 2014 ostensibly to help the Commission better understand and solve capital market structure problems. While Better Markets exposed the industry dominance of the committee and the irony that it included several members whose firms had violated the rules of the markets, these committees remain important hotbeds of de-regulatory thought and attention must remain on them.[23] Not surprisingly, the EMSAC has little to show in the way of constructive recommendations for improvements in market structure that will benefit investors and enhance market integrity.

Small budgets and de-regulatory leadership. Congress and the Administration are using both strategies to ensure that the regulatory agencies are headed by leaders aligned with a de-regulatory philosophy. In addition, the budgets for the agencies are being kept level or even being reduced—notwithstanding the vast markets these agencies oversee and the enormous importance of their task in safeguarding the public.

C. In the courts

Increased use of litigation. Following passage of the Dodd-Frank Act and the promulgation of many of its implementing rules, industry opponents increased their efforts to thwart regulation by challenging rules or other agency actions in court. The long list of such cases includes legal challenges to (1) the FSOC's designation of MetLife as a systemically important financial institution; (2) the DOL's fiduciary duty rule; (3) the risk retention rule jointly

---

comment requirements of the APA are not applicable to "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice").

23 *See* Better Markets' letter to then SEC Chair Mary Jo White calling on her to remove members of EMSAC who had violated the securities laws, Oct. 22, 2015, https://bettermarkets.com/newsroom/better-markets-calls-sec-remove-financial-industry-lawbreakers-equity-market-structure.

promulgated by multiple agencies, as applied to collateralized debt obligations; (4) the constitutionality of the SEC's administrative law judges under the Appointments Clause; (5) the CFTC's rule requiring investment companies engaged in significant swaps activity to register as a commodity pool operator; (6) the attack on the structure of the CFPB; (7) the SEC's conflicts minerals disclosure rules; (8) the government's bailout of AIG; and (9) the government's bailout of Fannie Mae and Freddie Mac.[24]

Theories. The legal theories advanced in these cases typically include allegations that the agency failed to provide adequate notice and an opportunity to comment; the rule or agency process was arbitrary and capricious because it ignored important considerations or adopted irrational approaches to the problem at hand; the agency failed to conduct an adequate cost-benefit analysis for the rule; or the agency's structure or process violated the Appointments Clause of the U.S. constitution, the Due Process Clause, or the First Amendment guarantee of freedom of speech.

Litigation by public interest advocates. Just as the financial services industry has sought to invalidate important financial reform rules in court, we expect public interest advocacy groups to do the same with increasing frequency, as the repeal of existing rules are proposed. The law clearly provides that when an agency seeks to change course and unwind or dilute a rule, it must observe the same substantive and procedural requirements that apply to rulemaking in the first instance.[25]

4. SPECIFIC CHANGES IN FINANCIAL REGULATION THAT WILL HAVE AN ADVERSE IMPACT ON CONSUMER PROTECTION, FINANCIAL STABILITY, AND MARKET INTEGRITY

A. Consumer protection

The DOL's fiduciary duty rule. In April, 2016, the Department of Labor finalized its fiduciary duty rule under the Employee Retirement Income Security Act of 1974, updating a regulation riddled with loopholes that had remained unchanged since 1975. The new rule is fundamentally simple: It requires all financial advisers to give advice about retirement assets that is in their clients' best interest—just as doctors and lawyers are bound to do. Under the rule, no longer will broker-dealers, insurance agents, and other advisers be allowed to recommend investments that pay handsome fees and commissions but saddle clients with high costs, poor returns, and excessive risks. And the rule provides especially important protections for IRA owners, who will have the right to participate in class actions when their advisers engage in systematic violations of the fiduciary standard.

Without the rule in place, American workers and retirees will continue to lose over $17 billion every year in savings, by extremely conservative estimates. Conflicts of interest have become increasingly damaging as traditional pension plans have faded away, and hardworking

---

[24] Cites for these cases are listed in Addendum C.

[25] *See* the analysis of the case law on this point in Better Markets' comment letter to the Office of the Comptroller of the Currency, Sept. 21, 2017, https://bettermarkets.com/sites/default/files/OCC%20-%20CL%20-%20Volcker%20Rule%20-%209-21-17.pdf.

Americans must rely on their own judgment and those they turn to for advice to manage their retirement assets.

The rule resulted from one of the most lengthy, data-driven, and open Rulemakings in history, including years of consultation with industry stakeholders, a robust economic analysis detailing the costs and benefits of the Rule, months of public comment, and nearly a week of hearings. The final rule also reflected significant accommodations to industry, allowing inherently conflicted compensation arrangements such as commissions to persist provided advisers comply with a set of exemptive conditions.

The rule has been subjected to a relentless assault since its inception, and once the rule was finalized, industry groups began filing legal challenges in multiple federal district courts. However, in every case to reach the merits, the courts have resoundingly rejected all of the industry's attacks.[26] And they have specifically found that the Rule will not restrict access to advice or products, disrupt the industry to the detriment of investors, or increase litigation risk to the point of forcing increases in the price of advice. Moreover, they repeatedly held that there was no basis on which to delay the rule pending the litigation or the appeal process. Three of the four cases are on appeal, and one remains in the district court in Minnesota.[27]

Better Markets has advocated long and hard in support of the rule, on its own and as co-founder of a coalition of public interest organizations including the AARP, the AFL-CIO, and the Consumer Federation of America that banded together to fight for the rule.[28] Those efforts were critical in helping bring the rule across the finish line, but now it faces fresh challenges under the new Administration. On February 3, 2017, President Trump ordered a review of the rule, without

---

[26] *See* Better Markets' Fact Sheets on some of the decisions, at https://bettermarkets.com/sites/default/files/DOL%20-%20Fact%20sheet%20of%20opinion%2011-8-16%20For%20Posting_0.pdf (*NAFA,* Dec. 27, 2016); https://bettermarkets.com/sites/default/files/DOL%20-%20Market%20Synergy%20Fact%20sheet%20of%20opinion%2012-2-16.pdf (*Market Synergy*, Dec. 2, 2016).

[27] *See Chamber of Commerce v. U.S. Dep't of Labor,* No. 17-10238, 2017 WL 1284187 (5th Cir. Apr. 5, 2017) ("*Chamber III*") (denying appellants' motion for injunction pending appeal and for expedited appeal); *Chamber of Commerce v. Hugler*, No. 3:16-cv-1476-M, 2017 WL 1062444 (N.D. Tex. Mar. 20, 2017) (*"Chamber II*") (denying appellants' motion for injunction pending appeal); *Mkt. Synergy Grp., Inc. v. U.S. Dep't of Labor*, No. 16-CV-4083-DDC-KGS, 2017 WL 661592 (D. Kan. Feb. 17, 2017) ("*Market Synergy II"*) (granting summary judgment to the Department of Labor); *Chamber of Commerce v. Hugler*, No. 3:16-cv-1476-M, 2017 WL 514424 (N.D. Tex. Feb. 8, 2017) (*"Chamber*") (granting summary judgment to the Department of Labor); *Mkt. Synergy Grp., Inc. v. U.S. Dep't of Labor*, No. 16-CV-4083-DDC-KGS, 2016 WL 6948061 (D. Kan. Nov. 28, 2016) ("*Market Synergy I*") (denying plaintiff's motion for preliminary injunction); *Nat'l Ass'n for Fixed Annuities v.* Perez, 219 F. Supp. 3d 10 (D.D.C. Nov. 23, 2016) ("NAFA II") (granting motion for expedited ruling and denying plaintiff's motion for preliminary injunction); *Nat'l Ass'n for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1 (D.D.C. Nov. 4, 2016) ("*NAFA I*") (granting summary judgment to the Department of Labor).

[28] *See* www.saveourretirement.com; *see also* Comment Letters from Better Markets to the DOL, dated July 25, 2015; Sept. 24, 2015; Mar. 17, 2017; Apr. 17, 2017; July 21, 2017; and Aug. 7, 2017, all available at www.bettermarkets.com.

citing any concrete basis or justification. Subsequently, the new DOL began a process of delaying the implementation dates pending the review process. On August 31, 2017, the DOL proposed a lengthy 18-month delay of major portions of the rule, including much of the important Best Interest Contract Exemption. A final delay rule is expected from DOL any day. A number of groups—including hopefully some states—will be closely evaluating the delay to determine whether it is subject to challenge under the APA. Regardless of the outcome of the pending court cases, the Trump-ordered review, and the DOL's delay proposal, the rule will continue to face the threat of Congressional repeal.

The SEC moves toward a fiduciary duty rule. In a closely related development, on June 1, 2017, the SEC began soliciting input from the public on a possible fiduciary duty rule that the SEC might promulgate under its Dodd-Frank Act authority.[29] In reality, this move appears to be part of a strategy to help delay and weaken the DOL rule. The SEC's initiative plays into the hands of those who have argued that the DOL should be forced to wait for and defer to the SEC—even though the DOL and the SEC have entirely separate statutory mandates and even though the SEC has no authority to regulate investment advice regarding any insurance products or other non-securities investments commonly found in retirement accounts.

The proof lies in part in the SEC's long history of inaction on crafting a fiduciary duty rule of its own. Section 913 of the Dodd-Frank Act gave the SEC explicit authority to adopt a broad fiduciary standard for brokers rendering investment advice, and the SEC's own staff studied the issue and in 2011 clearly recommended that the agency adopt such a rule. Yet the SEC did nothing for seven years, until the fight over the DOL rule reached a critical juncture. SEC Chairman Jay Clayton recently stated that the agency is indeed drafting a proposed fiduciary duty rule of its own. Better Markets and others will be engaging fully in that process to help ensure that the SEC's own fiduciary duty rule is more than a best interest standard in name only.[30]

States that have begun to fill the void. In a striking and positive development involving the states, Nevada passed a law in June of this year extending the fiduciary duty to all brokers and advisers, regardless of whether they are advising clients about retirement assets.[31]

The CFPB's arbitration rule. On July 10, 2017, the CFPB issued its rule protecting the rights of consumers to have their day in court and to hold banks and other financial companies accountable for repeated and widespread acts of fraud and abuse. The rule was based on Section 1028 of the Dodd-Frank Act, which gave the CFPB broad authority to "prohibit or impose

---

29 *See* SEC, 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.

30 The Consumer Federation of America has been a leading advocate for a strong SEC fiduciary duty rule for years, and their comment letter to the SEC in response to the RFI lays out in detail how the SEC should approach its task. *See* CFA Comment Letter to the SEC, Sept. 14, 2017, http://consumerfed.org/wp-content/uploads/2017/09/cfa-letter-to-sec-on-standard-of-conduct-rfi.pdf; *see also* Better Markets' Fact Sheet, DOL vs. SEC, "Best Interest" Fiduciary Rule (Aug. 8, 2017), https://bettermarkets.com/resources/dol-vs-sec-%E2%80%9Cbest-interest%E2%80%9D-fiduciary-rule-fact-sheet.

31 *New Nevada law imposes fiduciary duty on brokers*, Investment News, June 16, 2017, http://www.investmentnews.com/article/20170616/FREE/170619947/new-nevada-law-imposes-fiduciary-duty-on-brokers.

conditions or limitations on the use of" mandatory pre-dispute arbitration clauses. The agency first conducted a study of the use of mandatory arbitration clauses in consumer financial markets, as required by Section 1028. The final rule actually stopped short of outlawing all such agreements, only prohibiting clauses that prevent consumers from joining class action lawsuits.[32]

The need for the CFPB's arbitration rule is clear: Consumers who lose money as a result of deceptive or abusive conduct often cannot afford to retain a lawyer and sue on their own. This is particularly true if the damages are significant but still not large enough to interest a law firm seeking a share of any award. And it is even more true for consumers who are seeking to recover a smaller or more modest some. Magnified tens of thousands or hundreds of thousands of times, these fees add up to tens of millions or hundreds of millions of dollars in profits for the banks—ill-gotten gains, in fact. As Senator Lindsey Graham put it, “"Nobody is going to get a lawyer over a $10 overcharge, but when you overcharge millions of people $10, the bank or the credit-card company makes out like a bandit" in arbitration.[33] Class action lawsuits allow consumers to obtain relief for lower-dollar injuries by filing suit as a group and spreading the costs of litigation across many plaintiffs. And, the possibility of facing a class action lawsuit also serves as a powerful deterrent against fraud and abuse by banks.

Moreover, the data from the CFPB's report on arbitration belie the claim that class actions impose crushing liability on firms while only benefiting lawyers. In fact, the numbers clearly show that the danger of a torrent of litigation arising from class actions has been vastly overstated and that class actions are a far more effective means than arbitration for individual consumers to band together to fight back against financial firms when they have been swindled.[34]

And class actions are far more fair and transparent than arbitrations. When class actions are adjudicated, whether it be in a courtroom or through a negotiated settlement, strict rules of procedure apply. In fact, reforms over the past 20 years have made it difficult to bring class actions without strong evidence of systemic abuses by the bank, thus discouraging frivolous cases. In court, an impartial judge oversees the process. By comparison, arbitrators are typically people who have had long careers in industry and who are not bound to apply the law when deciding claims. Arbitration panels are not required to issue written decisions and rarely do. And the cases are strictly private, making it harder for regulators to spot widespread abuses at

---

32 *See* announcement and description of the rule from the CFPB, at https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-rule-ban-companies-using-arbitration-clauses-deny-groups-people-their-day-court/.

33 Tory Newmyer, *The Finance 202: The battle over suing big banks shifts into high gear*, Wash. Post, Aug. 7, 2017, https://www.washingtonpost.com/news/powerpost/paloma/the-finance-202/2017/08/07/the-finance-202-battle-over-suing-big-banks-shifts-into-high-gear/5987d40530fb045fdaef1151/?utm_term=.160096f3c2c8.

34 *See* the analysis set forth in the Better Markets blog, The Fight for CFPB Arbitration Rule Is About Ensuring Consumers Can Hold Big Banks Accountable, Sept. 26, 2017, https://bettermarkets.com/blog/fight-cfpb-arbitration-rule-about-ensuring-consumers-can-hold-big-banks-accountable; *see also* The Dirty Dozen, Why Mandatory Arbitration Is Unfair, Oct. 11, 2017, https://bettermarkets.com/newsroom/dirty-dozen-%E2%80%93-why-mandatory-arbitration-unfair.

banks—as we learned in the Wells Fargo scandal. Finally, unlike a court's decision, an arbitration award is almost impossible to appeal.

Unfortunately, the facts were not enough to ensure the survival of the rule under the CRA. The House passed its resolution of disapproval on July 25, 2017, and the Senate followed suit just this week on Tuesday. The vote in the Senate was 50-50 with Vice President Pence breaking the tie—a powerful illustration of the thin margins in play and the importance of strong advocacy from every quarter. In another step revealing the profoundly de-regulatory direction of the Treasury Department, on Monday, October 23, 2017, it released its own critique of the CFPB arbitration study, severely criticizing its findings.[35]

Payday lenders. On October 5, 2017, the CFPB finalized its rule aimed at curbing abuses by payday lenders, which extend short term loans to borrowers with limited income at exorbitant interest rates and with onerous full payment obligations at the end of the loan term. The payday lender rule is expected to be the target of Congressional Review Act nullification, although no such action has yet been taken in the House or the Senate.

SEC disclosure rules. In December of 2013, the SEC announced an initiative dubbed the "Disclosure Effectiveness Review," ostensibly for the purpose of facilitating more effective disclosures of material information in public company filings and financial reports. Yet the review process rests on the faulty premise that investors are experiencing "disclosure overload," a claim for which there is no credible evidence. As the Division of Corporation Finance proceeds with the review under Chairman Clayton's leadership, we and other advocates are concerned that the entire process is a veiled attempt to reduce the flow of important information to investors, not improve the disclosure regime for their benefit.

Executive compensation. Opposition to the executive compensation provisions in Title IX of the Dodd-Frank Act and the implementing rules remains fierce. Not all of the rules have been finalized, and those that have been may be targets for repeal. This set of rules is important as a matter of investor protection as well as financial stability. The financial crisis was caused in part by compensation practices and incentives that rewarded reckless, illegal, and sometimes criminal financial practices—from high-risk proprietary trading to rampant fraud in mortgage underwriting. From a consumer protection standpoint, the recent Wells Fargo scandal illustrated the extraordinary harm that a bank can inflict on millions of its customers when its entire incentive structure from top to bottom is focused exclusively on bringing in new clients, selling more accounts, and boosting the stock price to trigger the payment of personal bonuses—even if that means committing widespread fraud and identity theft in cross-selling.

---

[35] U.S. Department of the Treasury, Limiting Consumer Choice, Expanding Costly Litigation: An Analysis of the CFPB Arbitration Rule, Oct. 23, 2017, https://www.treasury.gov/press-center/press-releases/Pages/sm0186.aspx.

B. Safety and soundness of banks and the financial system

The Volcker Rule. The Volcker rule, mandated by Section 619 of the Dodd-Frank Act, is one of the single most important financial reforms implemented after the 2008 crisis to ensure our largest banks remain stable and our entire economy is protected from another financial crisis.[36] The rule's ban on proprietary trading by banking entities was included to address one of the root causes of the crisis. Leading up to the crisis, proprietary trading produced significant losses at large bank holding companies. These losses threatened the safety and soundness of those holding companies, disrupted important parts of the financial system threatening its stability, and required massive federal government rescue efforts to contain the effects on the financial system and the real economy. The proprietary trading ban was written to remove these risks from institutions that are central to the payment and credit system. It was also intended to eliminate any taxpayer subsidy of high-risk, speculative trading.

The threat to financial stability from proprietary trading at large banks has been widely recognized since the crisis. In a recent letter to Treasury Secretary Steven Mnuchin, Senators Jeff Merkley and Sherrod Brown cautioned against the assault on the Volcker Rule, citing to the key role that proprietary trading played in crippling several large financial firms whose failure precipitated the financial crisis:

> During the financial crisis, high-risk trading strategies and hedge fund businesses created or exacerbated significant losses at a variety of large financial institutions. The investment bank Lehman Brothers, which owned an insured depository institution, invested heavily in mortgage-backed instruments, eventually pushing the institution into the largest bankruptcy in U.S. history.[2] Hedge funds sponsored by the investment bank Bear Stearns, which also owned an insured depository, also suffered massive losses on their collateralized debt obligation (CDO) portfolios, required bailouts from the parent company, and then ultimately failed.[3] While these failures occurred within the independent investment banks, large bank holding companies also took proprietary positions in, and sponsored investment funds invested in, risky products like synthetic CDOs and credit default swaps.[4]
>
> [The Volcker Rule] responds to the lessons learned during the crisis by addressing risks associated with combining commercial banking and investment banking. It addresses inherent conflicts of interest and takes a step towards ensuring banking groups engage only in client-focused products and services and traditional activities like taking deposits and making loans. It is based on the simple premise

---

36 *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; Final Rule, 79 Fed. Reg. 5535 (Jan. 31, 2014).

[2] Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report, Jan. 2011, at 177; 326-42, fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

[3] Ibid, at 238-42.

[4] Ibid, at 379-82.

> that high-risk betting does not belong in or near institutions with access to the federal "safety net."[37]

Attempts to eliminate or scale back the Volcker rule have taken many forms. The CHOICE Act 2.0 would eliminate it, and the Treasury Department recommended major revisions in its first report issued in accordance with the review of all financial regulation mandated by President Trump. The report is clearly hostile to the Volcker rule and it plainly envisions a major dilution of its provisions. According to the report, the Volcker Rule has "far overshot the mark," it imposes extraordinarily complex and burdensome requirements, and it should be reduced in scope.[38] And recently, the OCC, one of the five agencies responsible for writing the rule, issued a Request for Information that clearly envisions major weakening of the rule.[39] While the RFI states that it is seeking information regarding rule revisions that would "better accomplish the purposes of the statute," its predominant goals are de-regulatory, couched in the familiar lexicon of those who seek to roll back financial regulation. It repeatedly refers to the goals of "decreasing the compliance burden," "narrowing the scope of application," creating "additional carve-outs," reducing undue "burden," and exploring ways in which the rule could be "tailored further," "streamlined," and simplified."

Once again, efforts to repeal or weaken the Volcker rule have no basis in fact. The letter from Senators Merkley and Brown cites to hard evidence showing that banks are more profitable than ever and that loan levels are also robust and climbing:

> There is little credible evidence that the Volcker Rule has harmed markets, or the economy. Preventing speculative bets has reduced volatility and, for those who have fully embraced its spirit of serving customers, has brought more, not less, stable profitability to the financial sector. The Volcker Rule is aimed at a goal that has broad support in Washington: focusing banks on making loans rather than risky proprietary bets. In that regard, it appears to be succeeding—in the first quarter of 2016, loans made by all federally insured institutions totaled $8,939 billion, a 7.0% increase over 2015.[8]
>
> In fact, the Volcker Rule was implemented without compromising bank profits. The banking industry's annual profits reached record highs in 2016,[9] when the

---

[37] Letter from Jeff Merkley, Senator from Oregon, and Sherrod Brown, Senator from Ohio, to Steven Mnuchin, Secretary of the Treasury (Sept. 7, 2017), https://www.merkley.senate.gov/news/press-releases/merkley-brown-raise-questions-about-new-attempt-to-weaken-volcker-rule; *see also* *Prohibiting Certain High-Risk Investment Activities by Banks And Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 49, at 1-2 (Feb. 2, 2010) (statement of Paul A. Volcker).

[38] U.S. Dept. of the Treasury, A Financial System That Creates Economic Opportunities, Banks and Credit Unions 71-72 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

[39] Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36692 (Aug. 7, 2017), at 36692-96.

[8] "Statistics At A Glance," Federal Deposit Insurance Corporation, 31 March 2016, https://www.fdic.gov/bank/statistical/stats/2016mar/industry.pdf.

[9] Ryan Tracy, "U.S. Banking Industry Annual Profit Hit Record in 2016," *The Wall Street Journal*, 28 February 2017, https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836.

industry's net income was $171.3 billion, 4.9% more than in 2015.[10] Ten of the nation's biggest lenders made $30 billion in the second quarter of 2017, just a few hundred million short of the record in the second quarter of 2007.[11] In 2017, the number of problem institutions, as defined by the Federal Deposit Insurance Corporation (FDIC), is down 88.12% since 2010.[12] Profits were $48.26 billion in the second quarter of 2017, up 10.72% from a year earlier.[13] As of June 2017, 95.9% of all insured financial institutions are profitable according to reports from the FDIC.[14][40]

As to the more targeted criticism that the Volcker Rule has impaired market liquidity, the evidence once again tells a different story. A case in point is a study that the SEC recently released finding no empirical evidence consistent with the hypothesis that liquidity in the U.S. Treasury markets has deteriorated after the Dodd-Frank Act regulatory reforms, including the Volcker rule, were put in place.[41] The report reached a similar conclusion about the corporate bond market, observing that trading activity has increased since the reforms were adopted and that transaction costs have remained low or actually decreased. And in testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs in April 2016, Antonio Weiss—counselor to Treasury Secretary Jack Lew—and Federal Reserve Board Governor Jerome Powell agreed that fixed-income markets, dominated by the markets for U.S. Treasury debt and U.S. corporate debt, are operating well and that no liquidity crisis exists.[42]

FSOC's designation authority. One of the most important reforms in Dodd-Frank was the creation of the Financial Stability Oversight Council, comprised of federal and state financial regulators and chaired by the Secretary of the Treasury. Its mission is to identify and respond to risks that threaten the financial stability of the United States, particularly in the shadow banking system. One of its most important tools is the authority to designate systemically significant nonbanks for heightened regulation if appropriate and after considerable data-driven analysis.[43]

---

[10] Ibid

[11] Yalman Onaran, "U.S. Mega Banks Are This Close to Breaking Their Profit Record," *Bloomberg Markets,* 21 July 2017, https://www.bloomberg.com/news/articles/2017-07-21/bank-profits-near-pre-crisis-peak-in-u-s-despite-all-the-rules.

[12] "Statistics At A Glance," Federal Deposit Insurance Corporation*,* 30 June 2017, https://www.fdic.gov/bank/statistical/stats/.

[13] Ibid

[14] Ibid

40 The Merkley and Brown Letter, *supra*.

41 Sec. & Exch. Comm'n, Report to Congress on Access to Capital and Market Liquidity (Aug. 2017), https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.

42 Andy Green & Gregg Glezinis, Phantom Illiquidity (Nov. 15, 2016), https://www.americanprogress.org/issues/economy/reports/2016/11/15/292313/phantom-illiquidity-a-closer-look-reveals-that-the-bond-markets-are-functioning-well/ (citations omitted).

43 *See generally* Better Markets Fact Sheet, "The Financial Stability Oversight Council: Saving Taxpayers from the Next AIG and the Next Crisis" (Nov. 2015) https://bettermarkets.com/sites/default/files/Fact%20Sheet%20-%20The%20Financial%20Stability%20Oversight%20Council%20--%2011-2-2015.pdf; *FSOC Accountability: Nonbank Designations, Hearing before the United States Senate Committee on Banking Housing, and Urban*

The FSOC has used its designation authority cautiously and deliberatively since 2010, applying it to only four institutions.[44] One was AIG, which not only failed spectacularly and engaged in outlandishly irresponsible conduct, but also required a huge $182 billion bailout. The other three were GE and two global insurance companies, Prudential and MetLife.

Nevertheless, FSOC and its designation authority are under attack. Initially, it came in the form of MetLife's lawsuit challenging its designation. MetLife prevailed and the case is on appeal to the D.C. Circuit.[45] Now the FSOC faces threats from within the Administration. President Trump issued an Executive Order in February requiring the Treasury Department to review FSOC's designation process. In a carefully choreographed maneuver, exemplifying the coordination among de-regulatory advocates, the Department of Justice then used that review process as a pretext for agreeing to stay the appeal--which if not derailed, may well lead to a reinstatement of MetLife's designation.[46] If the Department abandons the appeal altogether, then the district court's opinion would stand, dealing a severe blow to the FSOC's ability to designate nonbanks in the future.

The latest and most telling evidence of the new Administration's hostility towards FSOC's designation authority is the FSOC's recent vote to de-designate AIG, the gigantic global financial firm that was at the center of causing and propagating the catastrophic 2008 financial crash.[47] Relying on a questionable procedural device (the recusal of SEC Chair Jay Clayton),[48] the

Affairs (Mar. 25, 2015) (Testimony of Dennis Kelleher) https://bettermarkets.com/sites/default/files/Dennis%20Kelleher%20Testimony%203-25-15_0.pdf.

44 *See generally* U.S. Department of the Treasury, Financial Stability Oversight Council, Designations, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx .

45 *See MetLife v. Financial Stability Oversight Council,* 177 F.Supp.3d 219 (Mar. 30, 2017); *MetLife, Inc. v. Financial Stability Oversight Council,* No. 16-5086 (D.C. Cir.); *see also* Better Markets, Fact Sheet on the MetLife v. FSOC Decision: Overruling FSOC'S Designation of MetLife Was Flawed and Will Undermine Financial Stability (Apr. 15, 2016), https://bettermarkets.com/sites/default/files/MetLife%20Decision%20Fact%20Sheet%204-15-16%20Final.pdf.

46 Better Markets filed an amicus brief challenging the stay since the DOJ acquiesced in it. We argued that the DOJ should actually be disqualified from representing FSOC since its simultaneous representation of FSOC, the President, and the Treasury Secretary created unmanageable conflicts of interest in violation of applicable ethics rules. *See* amicus brief, filed July 25, 2017, at https://bettermarkets.com/sites/default/files/MetLife%20v.%20FSOC%20-%20Amicus%20Brief%20on%20Disqualification%207-25-17%20As%20Filed_0.pdf.
In addition, Better Markets intervened in the district court case to unseal the record, two-thirds of which was hidden from public view. The district court allowed the intervention but rejected our call for access to the record. We appealed, and on August 1, 2107, the D.C. Circuit ruled squarely in our favor, remanding the case to the district to conduct an appropriate and searching analysis to determine which records could be unsealed without compromising any genuine confidentiality concerns of the parties. *See MetLife, Inc. v. Fin. Stability Oversight Council,* 865 F.3d 661 (D.C. Cir. 2017).

47 Allistair Gray, Barney Jopson, and Ben McLannahan, "AIG freed from 'too big to fail' regulation", *Financial Times*, September 29, 2017, https://www.ft.com/content/263488f0-a48f-11e7-b797-b61809486fe2?sharetype=share; Allistair Gray, "AIG sheds $150m in costs along with Sifi label" *Financial Times*, October 1, 2017, https://www.ft.com/content/31b36b9a-a662-11e7-93c5-648314d2c72c.

48 The statute requires a two-thirds vote of the 10 voting members of FSOC to de-designate, which in this case would be impossible because there were three votes against de-designation and SEC Chair was recused from voting due to his or his law firm's prior representation of AIG. However, FSOC received a legal opinion

FSOC mustered 6 votes in favor of de-designating AIG.[49] This extraordinary step is among the first major financial regulatory decisions of the Trump administration and makes clear that its deregulatory rhetoric is going to become a reality. As Better Markets has explained in detail, the decision is extremely unwise and makes another costly financial crash more likely.[50]

Banking reforms. A number of other banking reforms arising from the Dodd-Frank are at risk of being eliminated or significantly scaled back. They include the orderly liquidation authority under Title II of Dodd-Frank, which creates a new process pursuant to which the FDIC may serve as receiver for large, interconnected financial companies whose failure poses a significant risk to the financial stability of the United States; the requirement that large banks prepare a "living will" describing the company's strategy for rapid and orderly resolution in the event of material financial distress or failure of the company; and the requirement that banks undergo periodic stress tests.

Money Markets reforms. The financial crisis proved that the run-risk facing money market funds could trigger or intensify a financial market collapse. During the 2008 crisis, U.S. taxpayers had to backstop the entire $3.7 trillion money market industry. While the SEC has implemented some reforms such as the floating NAV for institutional funds, more needs to be done. Moreover, there remains some pressure to repeal the SEC's prior reforms.

Derivatives regulation. Title VII of Dodd-Frank created a comprehensive new framework for swaps, which had been de-regulated in the Commodity Futures Modernization Act of 2000. These derivatives were at the heart of the 2008 crisis. Under Chairman Gary Gensler's leadership, the CFTC did an exemplary job of implementing those reforms through the rulemaking process. The new chairman, Christopher Giancarlo, is bringing a very different perspective, one marked by a desire to "streamline" or "simplify" the rules and reduce their burdens. Key reforms to watch are the approach to international or "cross-border" swaps regulation; the fate of the position limits rule intended to limit excessive speculation in the commodity markets; and the de minimis threshold that triggers the duty to register as a swaps dealer.

C. Capital formation and the markets

Market structure. The U.S. equity markets have become increasingly fragmented and vulnerable to technological breakdowns. The Flash Crash of 2010 provided an alarming warning of the fragility of our markets. Multiple exchanges and dozens of so-called "dark pools" now

---

that his recusal did not have to count toward the vote tally, allowing de-designation based on a 6-3 vote. *See* Zachary Warmbrodt, "AIG Escapes Tougher Regulation 9 Years After Bailout," Politico Pro, September 29, 2017.

49 U.S. Department of the Treasury, Financial Stability Oversight Council, Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding American International Group, Inc. (AIG) (2017), https://www.treasury.gov/initiatives/fsoc/designations/Documents/American_International_Group,_Inc.(Rescission).pdf.

50 Better Markets, Special Financial Reform Newsletter: Deregulating AIG Is an Historic Mistake That Sends a Terrible Message, Oct. 2, 2017, https://bettermarkets.com/newsroom/special-financial-reform-newsletter-deregulating-aig-historic-mistake-sends-terrible.

provide trading venues for order execution. Many of these trading venues cater to market participants who take advantage of long-term, everyday investors. For example, high frequency traders gain preferential access to trading data and use that information to trade ahead of others in the market, virtually guaranteeing a profit—which comes out of the pockets of average retail investors. In addition, to attract order flow, exchanges offer rebates to brokers with orders to fill. That creates a conflict of interest, since brokers may route their orders to the venue that offers the highest rebate, at the expense of the client who is entitled to "best execution" of the trade.[51]

Action by the SEC to address these problems is long overdue. Providing a rare ray of hope, recent reports indicate that the just-appointed new Director of the SEC's Division of Trading and Markets, Brett Redfearn (from J.P. Morgan Chase), may want to focus on the exchanges' habit of selling preferential data access and may initiate steps to ensure that the markets are more fair and competitive. Whether and when this might happen remains unclear. With respect to rebates, the SEC is in the final stages of establishing a pilot program that will test the effect of limiting those fees. This recommendation was put forth over a year ago, yet the final implementation of the pilot may be flawed to start with, as it may not include a "no rebate" option to be tested by the exchanges. The real question that must inform the regulatory response to these challenges is this: Are the markets being operated for the benefit of long-term investors or short-term profit seekers? In many respects, at least, the answer appears to be the latter.

Capital formation. In a separate legislative initiative following passage of the Dodd-Frank, Congress passed the JOBS Act on April 5, 2012, in a claimed effort to stimulate capital formation and promote job growth. It focused largely on providing more regulatory relief for private offerings, including a mini-registration process known as Reg A+ for offerings seeking to raise up to $50 million; a new crowdfunding mechanism; a provision allowing general solicitation in the already widely used Reg D, Rule 506 offerings; and higher thresholds for triggering reporting obligations under the '34 Act. In addition, it created relief for "emerging growth companies" seeking to go public, allowing them to submit draft IPO registration statements to the SEC for nonpublic review; to test the waters with potential investors; to submit two instead of 3 years of financials; and to defer compliance with many of the Dodd-Frank executive compensation requirements.

SEC Chairman Jay Clayton has made it a priority of his tenure to make it cheaper for non-public companies to become public companies and to remain so. He shares the view that the IPO market needs to be rejuvenated and that an important way of doing so is to reduce the regulatory obligations imposed on public companies. So far, this call for de-regulation is accompanied by little if any thoughtful and thorough analysis regarding the true health of the

---

51 Better Markets filed a comment letter with the SEC in response to a rulemaking proposal that would require broker-dealers to disclose how they route customers' orders, available at https://bettermarkets.com/sites/default/files/SEC%20-%20CL%20-%20Disclosure%20of%20Order%20Handling%20-%209-26-16_0.pdf.

IPO markets, the roots causes of any genuine downturn, or a convincing case that further de-regulation is the answer.

Cybersecurity. Recent hacks of critically important databases, including Equifax and the SEC's own EDGAR system, have brought new urgency to the challenge of keeping up with technological evolution and protecting our systems and databases from technical failure or sabotage. Better Markets called for the SEC to implement the "Equifax rule," which would at least require companies to disclose any significant hack to their systems as "material information."[52] Recent testimony and comments by SEC Chair Clayton indicate that cybersecurity will be a major focus for the SEC going forward.

Consolidated Audit Trail (CAT). Reform advocates have for years insisted that the SEC needs a state of the art database and tracking system that captures all trading activity in real time, to reconstruct flash crash events and to detect and eliminate abusive trading practices. Following a tortuous process, a CAT system designed by an industry contractor is soon to come online. Better Markets has decried the system's shortcomings, including its already outdated performance capabilities and the SEC's lack of control over the system and the database.[53] Recent concerns about the security of the SEC's own databases may pose additional obstacles and create additional delays in the operation of the system. Many in the industry who were never enthusiastic about the prospects of the SEC having powerful surveillance tools are now using cybersecurity concerns to further impede operation of the system.

Credit Rating Agencies. These market participants played a major role in facilitating the origination and sale of billions of dollars in toxic, fraudulent mortgage-backed securities that fueled the financial crisis. In short, they slapped triple AAA ratings on these products and looked the other way, all to protect their rating revenues. Pursuant to the Dodd-Frank Act, the SEC has implemented new rules that help address conflicts of interest inherent in the issuer-pay compensation model, but the job is not done. Dodd-Frank required the SEC to establish a new rating assignment system for complex structured products, known as the "Franken Amendment," but following a roundtable several years ago, the SEC has done nothing to move forward on that front.

5. WAYS TO DEFEND FINANCIAL REFORM

As the material above suggests, there are many ways to combat the de-regulatory effort underway, and with their own credibility and expertise, the states can be an important force in the fight. This list briefly highlights some key steps for engaging in support of strong financial regulation.

---

[52] *See* Better Markets' press release at https://bettermarkets.com/newsroom/sec-should-immediately-adopt-equifax-rule-require-companies-promptly-disclose-any.

[53] *See* Better Markets' Comment Letter to the SEC on Consolidated Audit Trail, https://bettermarkets.com/rulemaking/better-markets-comment-letter-sec-national-market-system-plan-governing-consolidated.

Keep abreast of developments. Given the complexity and variety of issues in play, staying informed is a challenge. Consider (1) subscribing to the Better Markets weekly newsletter; (2) gaining access to a reliable financial news service such as Politico Pro or Bloomberg; (3) visiting some excellent blogs, including, for example blog.themistrading.com, which combines market expertise with a deep understanding of the importance of strong financial regulation; (4) visiting either congress.gov or govtrak.us to track laws; (5) procuring a case docket tracking system, such as Lexis; and (6) routinely visiting agency websites for upcoming events, rule proposals, and other developments.

Engage on the Hill. This is appropriate and necessary when de-regulatory bills, CRA votes, or other measures are in play. Testimony at committee hearings can also make a valuable contribution in the fight to preserve financial reform. Even letters can have an impact, as evidenced by Senators and Congressmen often reading excerpts of correspondence from organizations and individuals during floor debates—as we saw this Tuesday during the Senate debate over the CFPB arbitration rule.

Submit comment letters. It is imperative that public interest advocates help build up the record during the rulemaking process, not only to help influence the agency's rule-writing staff, but also to lay the foundation for a possible legal challenge against a bad rule in court. Scheduling meetings with agency commissioners and senior staff members are also important.

Pass legislation. To the extent feasible, states should promote and pass legislation and rules that provide important regulatory protections where federal regulators have failed to act or have rescinded their own rules.

Go to court. Perhaps the most important tools we have in today's de-regulatory climate are lawsuits that challenge arbitrary and capricious agency rules and other actions. The states can be crucially important allies, as they can help establish the requisite Article III standing—a "stake" in the matter—that is the prerequisite for getting into court.

Addendum A

1. Bank Regulators

Entity	Chartering Agency	Primary Federal Regulator	
		Bank	Parent
National Bank	OCC	OCC	Fed
State Member Bank	State	Fed	Fed
State Nonmember Bank	State	FDIC	Fed
Federal Thrift	OCC	OCC	Fed
State Thrift	State	FDIC	Fed
Foreign Banks	Fed*	Fed	Fed

*The Federal Reserve approves foreign banks opening branches or representative offices in the US. If a foreign bank creates a subsidiary, it would be chartered the same as an American owned bank.

Note also: The NCUA, or National Credit Union Administration, regulates federally chartered credit unions.

2. Consumer Financial Protection: The Consumer Financial Protection Bureau (CFPB) has concurrent supervisory authority to enforce consumer protection laws on all depository institutions whose value is above $10 billion. 12 U.S.C. § 5515 (2012). The CFPB may also require reports from smaller depository institutions through the cooperation of a prudential regulator. 12 U.S.C. § 5516 (2012). Finally, it also has the authority to regulate and may supervise "covered persons" which are defined as 1) mortgage lenders 2) payday lenders 3) educational loan lenders 4) any "larger participant of a market for consumer financial products" and 5) anyone who offers financial services which the CFPB has reasonable cause to believe poses a risk to consumers. 12 U.S.C. § 5514 (2012)

Prudential Regulator links:

https://www.federalreserve.gov/
https://www.occ.treas.gov/
https://www.fdic.gov/
https://www.consumerfinance.gov/

2. Equities, stock options, and bonds: The Securities & Exchange Commission (SEC), www.sec.gov, oversees these markets, largely through the efforts of two "SROs" or Self-Regulatory Organizations
   a. FINRA, or Financial Industry Regulatory Authority
   b. MSRB, or Municipal Securities Regulatory Board

3. Commodity futures, commodity options, and swaps: The Commodity Futures Trading Commission (CFTC), www.cftc.gov., oversees these markets, also through the efforts of an SRO, the NFA or National Futures Association.

4. Housing: The Federal Housing Finance Agency (FHFA), www.fhfa.gov, is the primary regulator of the housing finance market, through oversight of Freddie Mac, Fannie Mae, and the Federal Home Loan Banks.

Addendum B

Executive Orders and Memoranda

1. Core Principles for Regulating the United States Financial System, Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (requiring the Treasury Secretary to review all financial regulations).

2. Enforcing the Regulatory Reform Agenda, Exec. Order No. 13,777, 82 Fed. Reg. 12285 (Feb. 24, 2017) (requiring agencies to appoint Regulatory Reform Officers and Task Forces to oversee implementation of regulatory reform initiatives).

3. Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Orderly Liquidation Authority (Apr. 21, 2017) (requiring the Treasury Secretary to review the orderly liquidation authority).

4. Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council (Apr. 21, 2017) (requiring the Treasury Secretary to review the FSOC designation processes).

5. Reducing Regulation and Controlling Regulatory Costs, Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017) (requiring the repeal of two regulations for every new regulation that is promulgated and that any cost to the industry be balanced by the repeal of other regulations, regardless of the benefits of the new or rescinded rules).

6. Executive Office of the President, Presidential Memorandum for the Secretary of Labor on the Fiduciary Rule (Feb. 3, 2017) (requiring the Labor Secretary to examine the fiduciary duty rule to determine if it may adversely affect the ability of Americans to gain access to advice).

Appendix C

1. *Metlife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016) (declaring that FSOC's designation of Metlife as systemically important was arbitrary and capricious) (currently on appeal in the D.C. Cir).

2. *See Chamber of Commerce v. U.S. Dep't of Labor,* No. 17-10238, 2017 WL 1284187 (5th Cir. Apr. 5, 2017) ("*Chamber III*") (denying appellants' motion for injunction pending appeal and for expedited appeal); *Chamber of Commerce v. Hugler*, No. 3:16-cv-1476-M, 2017 WL 1062444 (N.D. Tex. Mar. 20, 2017) (*"Chamber II*") (denying appellants' motion for injunction pending appeal); *Mkt. Synergy Grp., Inc. v. U.S. Dep't of Labor*, No. 16-CV-4083-DDC-KGS, 2017 WL 661592 (D. Kan. Feb. 17, 2017) ("*Market Synergy II"*) (granting summary judgment to the Department of Labor); *Chamber of Commerce v. Hugler*, No. 3:16-cv-1476-M, 2017 WL 514424 (N.D. Tex. Feb. 8, 2017) (*"Chamber*") (granting summary judgment to the Department of Labor); *Mkt. Synergy Grp., Inc. v. U.S. Dep't of Labor*, No. 16-CV-4083-DDC-KGS, 2016 WL 6948061 (D. Kan. Nov. 28, 2016) ("*Market Synergy I*") (denying plaintiff's motion for preliminary injunction); *Nat'l Ass'n for Fixed Annuities v.* Perez, 219 F. Supp. 3d 10 (D.D.C. Nov. 23, 2016) ("NAFA II") (granting motion for expedited ruling and denying plaintiff's motion for preliminary injunction); *Nat'l Ass'n for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1 (D.D.C. Nov. 4, 2016) ("*NAFA I*") (granting summary judgment to the Department of Labor).

3. *Loan Syndications & Trading Ass'n v. Sec. & Exch. Comm'n*, 223 F. Supp. 3d 37 (D.D.C. 2016) (holding that the SEC's rule requiring that the securitizer of collateralized loan obligations retain an interest in the credit pool was not arbitrary and capricious) (on appeal to the D.C. Cir.).

4. *Raymond J. Lucia Companies, Inc. v. Sec. & Exch. Comm'n*, 832 F. 3d 277 (D.C. Cir. 2016), *reh'g en banc granted, judgment vacated* (Feb. 16, 2017)*, on reh'g en banc*, 868 F.3d 1021 (D.C. Cir. 2017) (finding that the SEC ALJ system did not violate the Constitution as the ALJs were not officers subject to the Appointments Clause) (on petition for cert.); *Bandimere v. Sec. & Exch. Comm'n*, 844 F.3d 1168 (10th Cir. 2016) (finding that the powers wielded by SEC ALJs were sufficient to make them officers subject to the appointments clause).

5. *Investment Co. Institute v. Commodity Futures Trading Comm'n*, 720 F. 3d 370 (D.C. Cir. 2013) (holding that the CFTC regulations requiring registration of Commodity Pool Operators were not arbitrary or capricious).

6. *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F. 3d 1 (D.C. Cir. 2016), *reh'g en banc granted, order vacated* (Feb. 16, 2017) (finding the structure of the CFPB violated the President's Article II Powers as chief executive and the remedy was allowing the at-will removal of the CFPB's Director) (pending).

7. *Nat’l Ass’n of Mfrs. v. Sec. & Exch. Comm’n*, 800 F. 3d 518 (D.C. Cir. 2015) (holding that the SEC rule imposing disclosure of manufacturer’s use of conflict materials violated the First Amendment).

8. *Starr Int'l Co., Inc. v. United States*, 856 F.3d 953 (Fed. Cir. 2017) (rejecting shareholders’ claims for damages arising from AIG bailout) (on petition for cert.)

9. *Perry Capital LLC v. Mnuchin*, 864 F.3d 591 (D.C. Cir. 2017) (finding that the Housing and Economic Recovery Act barred the stockholders claims against the government).