



Consumer Federation of America

October 10, 2017

The Honorable Jeb Hensarling
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

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

We are writing on behalf of the Consumer Federation of America to urge opposition to several ill-considered bills scheduled for mark-up in the Committee this week. Although the bills are being promoted as benefiting capital formation, most simply adjust the rules that govern capital raising, sometimes in reckless and counter-productive ways, without doing anything to attract the new capital necessary to expand capital formation. On the contrary, by stripping away protections for investors, the providers of capital, several of the bills would undermine confidence in the integrity of the markets, which is essential to a healthy capital formation process. Other bills, by favoring private markets over public markets, threaten to worsen the decline in the number of public companies, which is bad for investors and for the overall economy.

The following are among the most harmful bills being marked up. In each case, we urge you to vote no. Our failure to include a bill on this list should not be read as support, particularly where the bills fall outside our focus on investor protection issues.

- Vote No on H.R. 3857, the “Protect Advice for Small Savers Act”

Few bills would do more harm to average, financially unsophisticated investors than H.R. 3857, the cynically misnamed “Protect Advice for Small Savers Act” or PASS Act. That bill would preserve the ability of broker-dealers and insurance agents to profit unfairly at their customers’ expense by repealing the Department of Labor’s fiduciary rule and putting a watered down, disclosure-based standard in its place. While the bill pretends to impose a “best interest” standard on brokers’ and insurance agents’ recommendations, it doesn’t actually require them to seek to do what is best for their customers. Nor does it do anything to eradicate the toxic conflicts that encourage and reward advice that is not in investors’ best interests. Instead, it gives firms the choice of avoiding, disclosing, or “reasonably” managing conflicts, with the predictable outcome that most will do nothing to rein in practices that are highly profitable for them, but very harmful to their customers. Investors who turn to financial professionals for advice deserve

real, trusted fiduciary advice. This bill denies them that assurance. We therefore urge you to vote no.

- Vote No on H.R. 3911, the “Risk-Based Credit Examination Act”

Recognizing that credit rating agency failures were a root cause of the 2008 financial crisis, Congress strengthened regulatory oversight of the ratings agencies, requiring annual inspections focused on key factors that undermine ratings reliability. For example, motivated by a desire to produce the inflated ratings needed to win ratings business, credit rating agencies often ignored their ratings policies and procedures, methodologies, and criteria and failed to properly apply their quantitative models. In response, Dodd Frank required the SEC to examine rating agencies on a yearly basis to ensure that they are not engaging in these same types of practices going forward. By adding just the two words, “as appropriate,” to the requirement that SEC inspections focus on these key risk factors, this legislation would significantly increase the likelihood that credit rating agencies would be able to engage in the same practices that were central to causing the financial crisis without any accountability. This is particularly troubling in light of the fact that SEC inspections have continued to find fundamental failures in rating agency practices, but the SEC has done little if anything to hold ratings agencies accountable. Instead of holding the SEC’s and rating agencies’ feet to the fire, this legislation would provide SEC staff with seemingly complete discretion over what practices to examine and when. Moreover, as we have seen in other contexts, credit rating agencies could be able exploit the “as appropriate” language to require the SEC to provide economic analysis showing the need for and appropriateness of examinations, and challenge that analysis in court, further undermining the SEC’s oversight program. Because it would embolden rating agencies to return to practices that were so detrimental on our financial system and broader economy, we urge you to vote no on this bill.

- Vote No on H.R. 2201, the “Micro Offering Safe Harbor Act”

This legislation would create yet another unnecessary and unwarranted exemption from the Securities Act of 1933 to enable the sale of micro-cap offerings (those involving sales of securities valued at \$500,000 or less in a single year) without appropriate regulatory protections. While the legislation would limit the total number of investors in such offerings, it includes no requirement that those investors have the financial sophistication to understand the potential risks of the offering or the financial wherewithal to withstand any losses. Instead, it requires only that they have a “pre-existing relationship” with an officer, director or major shareholder of the issuer, a condition that provides no meaningful protections. The bill: doesn’t require issuers to notify regulators of the offering; doesn’t require them to provide even the minimal disclosures required under Reg D; doesn’t impose any limits on the amount individuals can invest, and doesn’t include any restrictions on secondary sales. In addition, the bill preempts state authority over what are likely to be predominantly local offerings, raising the very real concern that there will be no meaningful regulatory oversight of these offerings. Certainly, the SEC doesn’t have the resources to provide that oversight for offerings of this type. Because this exemption would quickly and predictably become an avenue enabling questionable offerings to avoid regulatory scrutiny, causing countless retail investors to suffer devastating losses, we urge you to vote no.

- Vote No on H.R. 1585, the “Fair Investment Opportunities for Professional Experts Act”

If all it did was add licensed securities professionals and other subject matter experts to the list of those who qualify as accredited investors, this would be an uncontroversial, albeit largely inconsequential, bill. However, this bill also would lock in place an approach to the definition of accredited investor based on financial thresholds that have been shown to be ineffective in defining a population of investors capable of fending for themselves without the protections afforded in the public market. While we appreciate that the amendment in the nature of a substitute makes significant improvements to the bill, including by adjusting the net worth threshold to keep pace with future inflation, we nonetheless have concerns about this approach. Among other things, we are concerned that adoption of the bill would foreclose the opportunity to develop more thoughtful approaches that have the potential to expand the pool of individuals who qualify as accredited investors without the same increased risk. (We refer, for example, to the proposals recommended by the SEC’s Investor Advisory Committee, available here: <http://bit.ly/22HoUHw>.) And toward what end? If successful, this bill would make it modestly easier for companies to raise capital in our *private* markets, undermining efforts to stem the decline in public companies.

- Vote No on H.R. 1645, the “Fostering Innovation Act”

This legislation would extend the period of time in which certain public companies would be exempt from a requirement that provides important protections against financial reporting errors, including errors that are the result of fraud. That is the requirement, under Section 404(b) of the Sarbanes-Oxley Act which requires auditors, as part of their audits of public company financial statements, to assess and attest to the adequacy of the company’s internal controls to ensure accurate financial reporting. Moreover, this bill would extend this exemption for up to five years to a class of companies, including those that have gone public but may be struggling to produce significant revenues, and that could have a particular incentive to manipulate their financial statements in order to attract more capital. Companies should not be permitted to raise capital in the public markets if they do not have adequate controls in place to prevent financial reporting errors and fraud. And auditors cannot reasonably attest to the accuracy of a company’s financial statements without carefully assessing those controls. Requiring auditors to attest to the adequacy of those controls as part of the financial statement audit contributes to the market transparency and integrity that is essential to a healthy capital formation process. Moreover, the number and severity of financial restatements has declined since the requirement was adopted, which demonstrates that these requirements have benefited the market significantly. Because this bill would both harm investors and undermine the integrity of our capital markets, we urge you to vote no.

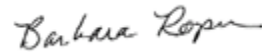
- Vote No on H.R. 3948, the “Protection of Source Code Act”

At a time when algorithmic trading is taking on increased importance in our capital markets, this bill would make it more difficult for the SEC to properly oversee such trading. The bill would require the SEC to first issue a subpoena before it compels a person to produce or furnish to the SEC algorithmic trading source code or “similar intellectual property.” This would undermine the SEC’s examination authority by creating a gaping hole in its ability to gain access

to firm records relevant to the examination. It would also have a devastating effect on the agency's ability to respond quickly in the event of another "flash crash" or other such events in the future. In order to oversee the markets effectively, the SEC needs to be able to accurately and efficiently reconstruct order entry and trading activity, including for algorithmic traders. Because this bill would weaken SEC oversight of a critically important aspect of market activity, we urge you to vote no.

We are disappointed that the Committee continues to devote its time and energy to passage of bills that strip away vital investor protections, undermine market stability, and further erode the transparency and integrity of our public markets. Please feel free to contact us if you have any questions about our positions on these bills.

Respectfully submitted,



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Director of Investor Protection



Micah Hauptman
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