April 14, 2017

United States Senate Banking Committee
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

Better Markets[1] appreciates the opportunity to submit our views in response to your request for input on proposals to encourage market competition and consumer confidence.

Economic growth requires strong rules of the road

We start with a fundamental, often forgotten concept: financial regulation and economic growth are not mutually exclusive. Indeed, such thinking frames the issue as a false choice when, in fact, durable, sustainable economic growth requires effective financial rules that ensure a balanced, competitive financial sector that supports the economically productive real economy.

This is because the U.S. financial system is much better capitalized and much less leveraged, with lower risk and activities channeled into supporting the economy rather than, for example, proprietary trading. This has been proved by overwhelming evidence. For example:

- As recently reported by the FDIC, not only is the financial sector seeing record profits, but loan balances for the industry were up more than 5% last year and up an astonishing 8% for community banks.[2] With GDP growth of roughly 2%, <u>bank lending is growing at twice the rate of economic growth,</u> and is clearly a source of strength for the country.

- Federal Reserve Board Chair Janet Yellen recently testified before the Senate Banking Committee that commercial and industrial lending has surged in recent years, as have industry profits.[3] "There's much more capital in the banking system," Chair Yellen testified. "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."

- FDIC Vice Chairman Thomas Hoenig just this week noted the benefits of higher capital requirements for both individual banks and the economy. His statement is worth quoting at length:

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.
[2] https://www.fdic.gov/news/news/speeches/spfeb2817.html
[3] http://www.cnbc.com/2017/02/14/janet-yellen-banks-are-lending-and-quite-profitable.html

> The data show that by any number of measures, the benefits of higher capital outweigh the costs. Global banks with stronger capital as measured under the leverage ratio and with fewer problem assets generally trade at a premium or at less of a discount to book value than banks with weaker capital. Better capitalized banks lend more and do so on a sustained basis over the business cycle, and they are less likely to fail or require bailouts. As capital levels have increased since 2009, loans have increased by $2.1 trillion, or 4 percent a year on average, and bank earnings have continuously improved. In other words, capital does not remain idle. Along with debt, capital is a primary source of funding for lending. As tangible equity grows from retained earnings, lending and earnings continue to grow.[4]

That these statements were all made **after** the Dodd Frank financial reform law has been almost entirely implemented and enforced clearly provides real time, real life evidence that financial reform has not hurt either the banks or the economy.

It's clear that financial industry stakeholders also understand the value of the Dodd Frank rulemaking generally, and higher capital requirements in particular. For example, current National Economic Council Chair Gary Cohn acknowledged as much last year when, as Chief Operating Officer of Goldman Sachs, he stated on Bloomberg TV that:

> Almost all US banks took our medicine [recapitalizing, restructuring and implementing financial reform rules] early. We went out and raised capital really early in the process and then we went out and raised capital a second time…. We really built our balance sheet up. We really de-leveraged ourselves. We really built enormous excess liquidity….And we made ourselves as financially secure as we could.
>
> We're subject to enormously robust stress tests here in the United States, and I give the Fed enormous credit for what they've done in stress testing the major banks here in the United States. [It's t]o the point where no one should question the viability of the big U.S. banks. I think some of the European banks have been slow to getting themselves recapitalized and getting their financial balance sheet in the best place it can be.[5]

Economic growth and jobs simply will not come from the finance-driven boom and bust economic cycles that have plagued the country since the 1990s. The only way to get financial firms, including but not limited to, banks, back into the business of financial activities that support the real economy is to limit their involvement in the high-risk trading activities and complex transactions that enrich Wall Street, but do nothing to promote real jobs and growth on Main Street.

A necessary foundation for achieving an environment of sustainable and durable economic growth is ensuring that financial stability, transparency, a level playing field, clear rules, oversight, and accountability are applied to all financial firms and bankers, just like everyone else.
As the statistics on lending show, it is stagnant consumer demand holding back economic growth, which is a direct result of the financial collapse and economic crisis, as we detailed in our *Cost of the Crisis* report.[6]

---

[4] https://www.fdic.gov/news/news/speeches/spapr1317.html

[5] https://www.bloomberg.com/news/articles/2016-02-09/u-s-banks-safer-than-europeans-due-to-early-medicine-cohn-says

[6] https://www.bettermarkets.com/newsroom/better-markets-releases-cost-crisis-report-detailing-how-financial-crash-will-cost

It must be remembered that the financial crash and economic crisis were the direct result of little or no oversight of the increasingly risky and short-term-focused behavior of some of the world's largest and most dangerous financial companies. The answer is clear: to fix the demand problem, we need to restore investor confidence, have the financial system focused on lending to the real economy, and ensure economic growth is not killed by another financial crash.

Consumers won't invest in a market they perceive as rigged or unfair

Regulated, transparent markets with less fraud and reckless conduct will first restore confidence and then participation in our markets. That will inevitably lead to economic growth. Transparency and a level playing field will promote competition as firms enter the market and provide more services at lower costs. If done correctly, sensible and targeted regulations that promote financial reform and stability will result in more industry diversification, lower prices, more jobs, more competition and economic growth with greater safety for the entire system.

A public opinion survey in April 2016 found that the number of Americans who invest in the stock market was at a record low, down 13 percentage points from its 2007 high.[7] Growing numbers of Americans are sitting out the market's record run-up.[8] Why?

Because, as demonstrated in a survey conducted by Better Markets, they perceive it as rigged.[9] Respondents across the political spectrum said they believe the stock market is "rigged for insiders and people who know how to manipulate the system" and an incredible 90 percent of respondents were dissatisfied with the federal government's actions regulating Wall Street.[10] And is it any wonder? Investors are understandably dismayed and discouraged by the spectacle of Flash Crash and predatory high-frequency traders front-running retail orders to enrich themselves, the many LIBOR and benchmark rigging scandals, and story after story of the country's largest Wall Street financial firms finding new ways to profit at the expense of their customers.

Better Markets proposes three steps to help promote consumer confidence in the markets:

1. Boost Consumer Confidence by Enacting Credit Rating Agency Reform: One of the more important reforms in Dodd-Frank was requiring the SEC to establish a system to prevent the issuer or securitizer of bonds from selecting which rating agency would determine the initial rating for the issuance. This reform, known as the Franken Amendment, would reduce the conflicts of interest that are present when issuers select (and pay) the rating agency of their choice.

   The SEC has yet to implement the Franken Amendment. Investor confidence in the reliability of bond ratings will increase when conflicts of interests between issuer and rating agencies are reduced. With increased investor confidence, more capital would flow into both corporations and municipalities who issue debt, in the process leading to job creation and economic growth.

[7] http://www.cnbc.com/2016/12/09/even-as-stocks-surge-half-of-americas-are-losing-out.html
[8] http://money.cnn.com/2014/04/21/investing/stocks-investor-survey/
[9] http://www.latimes.com/business/la-fi-wall-street-regulation-dodd-frank-poll-20140717-story.html
[10] https://www.bettermarkets.com/sites/default/files/National%20Poll%20on%20the%204th%20Anniv%20of%20Dodd-Frank_1.pdf

2. Fix the Broken Industry-biased Arbitration System or Reassure Consumers They'll Get Their Day in Court if They are Wronged: Many companies, from investment advisors and credit cards to powerful corporate entities like Wells Fargo, use a clause hidden deep within their customer contract to prohibit aggrieved customers from filing lawsuits against them, no matter how serious the crime or damaging the impact.

   The widespread use of these mandatory arbitration clauses helps erode investor confidence in the market, as these policies prevent citizens from filing class action lawsuits that are often the only redress for customers, and the most effective deterrent to corporations committing fraud or otherwise scamming their customers.

   A hidden cost of mandatory arbitration is the way these policies help companies continue their activities by suppressing any public disclosure of wrongdoing. As the *Los Angeles Times* explained in its exposé of the Wells Fargo fake accounts scandal, many customers were pushed into settlements that are "good example[s] of how the bank could bury facts related to its scandal. With the settlement, not only the details of how the clients could have been defrauded, but the issue of the arbitration clause, was closed."

   If the arbitration system is maintained, it must be overhauled so that it is in fact a low-cost, fair, and effective alternative dispute resolution forum, instead of an opaque and secretive process that is often biased against investors. It should be an attractive and credible option that investors are willing to choose over litigation, instead of a rigged forum they are forced into against their will.

3. Ensure the Cops on the Wall Street Beat are Well-Funded: The CFTC and SEC are the cops on the Wall Street beat, the front-line defense protecting America's workers, taxpayers, and communities from financial predators and market-rigging. However, these agencies have been chronically underfunded for years. This enduring underfunding ultimately acts to further the erosion of consumer trust in the financial system.

   Take, for example, the CFTC. Title VII of Dodd-Frank ushered in sweeping changes that expanded the CFTC's regulatory and supervisory jurisdiction from a notional estimated $27 trillion market to $320 trillion market. However, in response to this more than 10-fold expansion of responsibility, the CFTC's budget was increased by just 15 percent, and has remained stagnant for the past four years.

   Grossly underfunding these agencies has allowed some on Wall Street to return to their high-risk pre-crash ways of doing business, endangering our financial stability and undermining the mission of financial reform. Accordingly, the American people will not be protected from reckless, irresponsible, and, at times, criminal behavior in the financial industry until the SEC and CFTC are fully funded.

Preventing a financial crisis is the surest way to protect economic growth
The economic wreckage caused by the 2008 crash nearly a decade ago touched every corner of our country: high and persistent un- and under-employment, record high foreclosures and underwater homeowners, slow-to-no economic growth, business failures, untold wealth destruction, and a loss of faith in the American Dream.

We often hear claims that regulation has prevented banks from lending, has dried up liquidity, has limited capital formation, and, therefore, has hampered economic growth and job creation. But it is unmistakably true the financial crisis did more damage in those areas than any regulation ever could. In September 2008, there was no market liquidity or lending or capital formation, much less any economic growth or job creation. Further, the assertion is fundamentally wrong. Recent FDIC data show bank lending across all sectors continues to increase and banks are more profitable than ever.

It is an obvious point, but one which bears repeating: nothing kills consumer confidence and economic growth like a financial crisis. Consequently, protecting our hard-won economic gains, and preventing another crash, is job #1 for policymakers concerned about promoting economic growth and encouraging market participation. Our top priority must be to avoid the types of severe crashes that send markets reeling and set investors back by years, and that means avoiding the calls for deregulation that helped cause the crash in the first place.

Unregulated and non-transparent derivatives trading was a key cause of the 2008 financial crisis and its primary transmission mechanism. Derivatives were like an unseen conveyor belt spreading risk and financial time bombs throughout the global financial system. While important reforms have been made, the incumbent industry of dealers have prevented a number of them from being fully and properly implemented as intended (as detailed, for example, in this Policy Brief[11]). Here are some examples of steps that could be taken to address ongoing anti-competitive, anti-consumer practices:

1. Fulfill the Promise of a Truly Competitive Derivatives Market: The Dodd-Frank Act included the blueprint for essential improvements in the oversight of our derivatives markets. Completing the work that was begun under the Dodd-Frank Act could promote economic activity among small- and mid-tier financial firms, and reduce risk to the financial system.

   A key innovation of Title VII of Dodd-Frank was the creation of swap execution facilities (SEFs), which were supposed to be exchange-like trading venues where most, if not all, swap trading could be executed.

   If properly enacted, SEFs would bring transparency, oversight and competition to the swaps markets, which would also break up the oligopoly of Wall Street's derivatives dealers club. Pre-reform, a handful of Wall Street's biggest banks handled virtually 100% of US derivatives dealing, killing competition with impossibly high barriers to entry. This created enormous market clout and an unfair advantage for a few Wall Street dealer banks, as well as a systemic risk from concentrating the trade of hundreds of trillions of dollars of non-transparent and unregulated derivatives in just a few firms.

   The net result of the new derivatives rules was supposed to be well-functioning derivatives markets with a level playing field that reduced systemic risk while serving the needs of the real economy. That hasn't happened, largely because the Wall Street has filled the rules with loopholes and ambiguities that have enabled them to basically replicate the pre-crash derivatives markets. Most of the handful of large dealers who have always dominated the derivatives markets continue to do so.

   Therefore, we urge Congress to require action by the CFTC to break open these derivatives markets, stop the undue influence of the derivatives dealers' club, and protect taxpayers from systemic risk. To do that, Congress should require the following from the

[11] https://www.bettermarkets.com/keywords/stopping-wall-street%E2%80%99s-derivatives-dealers-club

CFTC and other regulators:

A) Regulators must accelerate full and meaningful implementation of the rules and subject ***all*** derivatives activities within the United States to the new reforms, as derivatives activities engaged in by traders located in the U.S. have a direct and significant connection to the U.S. and warrant oversight from U.S. regulators. Therefore, the CFTC should be required to immediately enforce this baseline principle – regulating all derivatives activities within the United States – and impose its existing rules, ceasing the continuous no-action relief to the dealers. Even if so-called "substituted compliance" were appropriate for some of these activities, U.S. regulators should not completely abdicate their responsibility of oversight before they ensure that foreign rules are in fact equivalent to U.S. standards in form, substance, and enforcement.

B) The CFTC's clear impartial access rules applicable to SEFs must be enforced, including an active prohibition on all practices designed to preserve prohibited dealer-only platforms, such as the legacy practice of post-trade name disclosure; and

C) U.S. regulators must only promote harmonization with global regulators to the extent US taxpayers are protected by, for example, ensuring substituted compliance isn't granted unless US core principles, such as impartial access, are implemented in an equivalent manner.

2. Repair Capital Market Structure and Create a Robust Consolidated Audit Trail: Investors suffer when preferential data access confers unfair advantages on a select number of market participants at the expense of others. Investors suffer when high frequency trading practices exploit other market participants, creating the illusion of market liquidity, and contribute to extreme volatility. Investors suffer when trading venues offer rebates that distort trading practices. Investors suffer and investor confidence drops when markets crash, reducing companies' access to capital and stifling economic growth. Therefore, it is critical the SEC begin in earnest to repair features of the capital market structure in the following ways:

A) Ban Rebates: Today, large exchanges and other trading venues offer rebates to attract order flow, distorting trading practices. Brokers, instead of seeking best-execution for the investors, route their orders to venues that offer the largest rebates. While brokers enjoy these rebates, investors suffer because of subpar execution quality. Removal of rebates will reassure investors that orders are routed in their best interest, and reduce the amount of time and resources devoted to chasing rebate tiers. Greater investor confidence should increase participation in the markets, lowering costs for companies in need of capital.

B) Increase Competition in Market Data: Introduce competing data aggregators so that exchanges do not control the economics of market data. This will both reduce costs to brokers and investors, and will improve investor confidence by reducing the influence of exchange data available to a subset of participants.

C) Require review of Algorithms and Ban Dangerous and Disruptive Algos: Today, broker-dealers and Alternative Trading Systems use algorithms designed to exploit technological advantages and/or proximity to markets. These artificial-intelligence based algorithms are not reviewed by an independent party or regulators charged to ensure the stability of the financial system or protection of investors. The SEC must be required to review these algorithms before they are used, and be authorized to ban those found to be dangerous or disruptive, or designed to manipulate the markets. Eliminating artificially created disruptions of the markets will increase investor confidence and participation in the markets.

D) Ensure Consolidated Audit Trail (CAT) Comes Online On-time: The SEC approved the final CAT NMS Plan in November 2016, but it needs to be more robust, comprehensive, and real-time. The CAT will track securities trades throughout their lifecycle and identify the broker-dealers handling them, thus allowing regulators to more efficiently and accurately track trading activity throughout the U.S. markets. The CAT is scheduled to become operational by November 2017, and fully operational by November 2019. Congress must ensure the SEC appropriately oversees the implementation of this timeline, and that CAT is upgraded on regular intervals.

Increase Community Bank Investments in Local Projects
An innovative way to lower borrowing costs for municipalities, which would in turn encourage them to increase infrastructure spending, is to create a class of regional bond banks that will purchase loans made by community banks to municipalities. Community banks are best placed to make these loans to their state and local governments. Currently, these banks only do private placements with municipalities, and the banks hold these loans on their assets sheet. With regional bond banks, the community banks could offload these loans to them, allowing them to lend more.

History shows, fair rules of the road encourage economic growth
The Committee's request for legislative ideas to encourage economic growth will no doubt result in a flood of proposals from the many in the financial industry arguing that they must be deregulated to free up the market and unleash its economic potential.

It is important that the Committee recognize these arguments for what they are: self-interested and self-serving calls for mindless deregulation to unleash unlimited profits for banks and the shifting of risk to the taxpayer. History shows reasonable, thoughtful regulation of the financial sector, as has been implemented since 2010, is not only compatible with economic growth, it is a necessary condition for prolonged growth and wealth-building.

Following the Great Depression, Congress enacted a series of laws and regulations to protect the American people from Wall Street's recklessness. The bank lobby at the time said it would kill growth, jobs and, indeed, capitalism itself. What was the result of that unprecedented government regulation of Wall Street and the U.S. capital markets? 70 years of unparalleled prosperity and growth, as America grew and built the largest and most broad-based middle class in the history of the world; our securities markets flourished and became the envy of the world; and Wall Street, our nonfinancial businesses and our economy all thrived.

In contrast, by 2000, many key financial protections had been dismantled, and Wall Street was largely un-regulated. The consequences came quickly; it took just 7 years for Wall Street's unregulated investment, trading, and other activities to cause what almost became a second Great Depression. Millions of American families are still suffering from that deregulation-fueled economic catastrophe:

tens of millions of jobs, homes, educations, retirements and savings lost. Economic stress, anxiety and insecurity still pervade too many kitchen tables. We simply cannot let that happen again.

In conclusion, we commend you for exploring these important issues. However, we also urge you to reject calls from industry to deregulate the financial industry, and to remain focused on sensible, targeted steps that will promote consumer confidence in, and restore competition to, the financial activities that support the real economy, producing jobs and growth

Sincerely,

Dennis M. Kelleher
President & CEO

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
www.bettermarkets.com