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NASAA

September 13, 2016

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
Washington, DC 20515

Re: Committee Markup of the Financial CHOICE Act of 2016 (H.R. 5983)

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I write to provide preliminary comments on H.R. 5983, the Financial CHOICE Act of 2016 (hereafter "the bill" or "the legislation"), which is scheduled to be considered by the House Committee on Financial Services ("HFSC") later this week. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") in July 2010, in response to the financial crisis of 2007-2009. The DFA enacted important reforms to strengthen our financial system and better protect the millions of hard-working Americans who rely on their investments for a secure retirement. While it is important to continue to evaluate the changes made by the DFA, as presently written, H.R. 5983 would dramatically shift regulatory policies in the wrong direction, weakening the important reforms and protections put in place under the DFA and exposing investors and the securities markets to significant, unnecessary new risks.

Given the legislation's extraordinary scope and breath, and its recent and swift introduction,[2] this letter will address only certain aspects of the bill, in the order they appear in H.R. 5983, that directly and adversely impact the ability of state securities regulators to effectively police U.S. securities markets, protect retail investors, and promote responsible capital formation.

Investor Advocate and Investor Advisory Committee:

NASAA is strongly opposed to provisions in H.R. 5983 that would weaken the independence and influence of the U.S. Securities and Exchange Commission ("SEC") Office of the Investor Advocate and the SEC Investor Advisory Committee ("IAC").[3] The bill would restrict

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] H.R. 5983 was introduced in the House on September 9, 2016.

[3] Sec. 409 of H.R. 5983 would make it unlawful for the IAC to submit recommendations to the SEC, whether in regard to rulemaking or legislation, except upon consultation with the SEC Small Business Capital Formation Advisory Committee, as

the Investor Advocate's authority to express views regarding legislation introduced in Congress.[4] It would also require the Investor Advocate and the IAC to consult and coordinate activities with unrelated SEC advisory committees. The cumulative impact of these provisions, included in Sections 409 and 410, would undermine the ability of the Investor Advocate and IAC to speak as an independent voice for the interests of retail investors, and weaken the credibility and independence of current and future SEC advisory committees.

Mandatory Pre-Dispute Arbitration:

Section 338 of H.R. 5983 would repeal Section 1028 of the Consumer Financial Protection Act of 2010, which empowers the Consumer Financial Protection Bureau, after a study and report of its findings to Congress, to restrict or prohibit the use of mandatory pre-dispute arbitration clauses in consumer financial products or services contracts.[5] NASAA believes that mandatory pre-dispute arbitration harms both consumers and investors and reiterates its longstanding opposition to the use of those provisions in customer contracts. We urge Congress to retain this important authority.

Elimination of Automatic "Bad Actor" Disqualification:

NASAA is very concerned with provisions included in Section 422 of H.R. 5983 that would eliminate certain automatic "bad actor" disqualification of natural and non-natural persons provisions unless the SEC, "by order, on the record after notice and an opportunity for hearing," makes a determination that such persons should be so disqualified or otherwise made ineligible for purposes of such provision. This provision is particularly troubling as it undermines the ability of the regulators to prevent a bad actor in one area of the securities industry from re-entering the securities industry in another area, and harming unsuspecting investors. It creates procedural burdens, allowing "bad actors" to continue to rely on exemptions, registrations and activities that led to those bad acts.

SEC Investigatory and Enforcement Authorities:

State securities regulators are also troubled by a number of provisions in Title IV of the bill that would unduly limit the SEC's ability to investigate securities fraud. While we recognize the bill's provisions that would increase the SEC's authority to assess civil fines in certain cases,[6] we also note that the bill includes a number of provisions that would impede the SEC's authority to pursue enforcement actions that deter bad actors and protect retail investors, including through the use of administrative actions. The authority to pursue remedies for alleged violations of federal securities laws in an administrative proceeding is an important tool in the SEC's arsenal and furthers the agency's mission to protect investors.[7]

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established by the bill. Sec. 409 would further mandate that at least one member of the IAC be a member of the Small Business Capital Formation Advisory Committee, who would serve in a non-voting capacity.

[4] The bill would also require that the Investor Advocate consult with the Advocate for Small Business Capital Formation on any proposed recommendations.

[5] In March 2015, CFPB released a 728-page study that analyzed the prevalence of arbitration agreements in consumer financial contracts, consumer understanding of arbitration, and the volume and nature of individual consumer arbitrations and individual and class litigations. Accessible at: files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[6] TITLE VIII, Subtitle A—SEC Penalties Modernization.

[7] See Sections 415, 416. 417, 418, 420, 421 and 424.

Repeal of Fiduciary Duty Rule:

NASAA opposes Section 441 of H.R. 5983, which would, among other things, invalidate the rule recently adopted by the U.S. Department of Labor until after the SEC issues its own final rule relating to standards of conduct for brokers and dealers. It would also impose additional regulatory, analytical, and economic analysis requirements on the SEC prior to any rulemaking. These provisions would establish several significant obstacles to SEC rulemaking, and severely undermine the on-going effort by the SEC to conduct such rulemaking.[8]

Transparency and Oversight of Advisers to Private Funds:

Sections 450 and 451 would unnecessarily weaken oversight of advisers to private-equity funds, including by repealing important provisions in the DFA that required the registration of advisers to such funds.[9] As recent SEC examinations have revealed, the scrutiny of advisers to private funds is important to the protection of investors in such funds, including limited partners, and even certain state pension funds. The registration of private fund advisers has brought much needed transparency to a significant segment of the markets. NASAA urges Congress to refrain from repealing provisions of the DFA that provide appropriate and overdue scrutiny of advisers to private funds.

Accredited Investor Definition:

NASAA opposes the provisions in Section 452 that would codify the existing income and net worth standards of the "accredited investor" definition and direct the SEC to establish new untested means for persons to qualify as "accredited investors." Such categories would include natural persons who are licensed or registered as a broker-dealer or investment adviser, and natural persons who the SEC determines, by regulation, have "demonstrable education or job experience to qualify . . . as having professional knowledge of a subject related to a particular investment."

As the Government Accountability Office and others have discussed, dollar thresholds have never been an accurate proxy for investor sophistication. Congress should refrain from embedding such flawed metrics, and new untested criteria, into our securities laws. Further, on December 18, 2015 the SEC issued a DFA mandated report on the definition of "accredited investor," as required by Congress, making recommendations on potential changes to the Commission.[10] Congress should allow the SEC to review those findings and any staff recommendations, prior to taking steps to codify additional changes to the "accredited investor" definition.

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[8] See NASAA Comment Letters, available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/2015-10-05-NASAA-DOL-Comment-Letter-3-RIN-1210-AB32.pdf and http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/2015-09-24-NASAA-Comment-2-RIN-1210-AB32.pdf.

[9] Sec. 450 (Exemption of and reporting by private equity fund advisers) and Sec. 451 (Records and reports of private funds).

[10] Section 413(b)(2)(A) of the DFA directs the SEC to review the accredited investor definition as it relates to natural persons every four years to determine whether the definition should be modified or adjusted for the protection of investors, in the public interest and in light of the economy. The first report is available at: sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf.

Capital Formation Proposals:

Title X of the Financial CHOICE Act incorporates numerous legislative proposals in the current legislative session pertaining to capital formation. NASAA has already commented extensively on a number of these proposals. However, we urge the Committee to review NASAA's previous positions, which should also be reflected in the Committee's official records.[11]

For purposes of this letter, however, we note that NASAA has raised concerns with provisions in Title X that would establish a national "venture exchange,"[12] restrict Form D filing requirements,[13] create a new safe-harbor for "micro offerings,"[14] further amend recently finalized federal crowdfunding rules,[15] and amend provisions relating to "covered security" status for securities listed on a national securities exchange.[16] NASAA also has questions about other bills included in this section, including those relating to angel groups and general solicitation.[17]

Thank you for considering NASAA's views. Please do not hesitate to contact me or Michael Canning, NASAA's Director of Policy, at (202) 737-0900, if we may be of any additional assistance.

Sincerely,

Mike Rothman
NASAA President and Minnesota Commissioner of Commerce

[11] NASAA Comment Letters are accessible at: http://www.nasaa.org/issues-and-advocacy/letters-congress/.
[12] Sec. 1056 (The Main Street Growth Act).
[13] Sec. 1066 (The Private Placement Improvement Act).
[14] Sec. 1061 (The Micro Offering Safe Harbor).
[15] Sec. 1076 and Sec. 1077 (The Fix Crowdfunding Act).
[16] Sec. 1096 (The National Securities Exchange Regulatory Parity Act).
[17] Sec. 1051 and 1052 (Helping Angels Lead Our Startups).