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LXR Group

Policy Bulletin

Bringing our clients and subscribers exclusive policy updates and analysis from the world of capital markets, fintech, investor protection and more.

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Analysis: HFSC Republicans Escalate, Announcing Back-to-Back SEC Oversight Hearings in Effort to Tighten Screws on Gensler.

On Thursday, June 15, HFSC Chair Patrick McHenry took the remarkable step of announcing consecutive oversight hearings of the SEC for next week. The hearings, which were not on the Committee's agenda until recently, represent an escalation in the increasingly acrimonious dispute between the HFSC Chair and other top HFSC Republicans, and the SEC Chair, largely over digital assets policy, and frustration over the SEC's recent and aggressive enforcement actions against large crypto exchanges and market intermediaries. In recent months, the HFSC Chairman and his lieutenants have repeatedly expressed strong displeasure with specific SEC rule proposals and what they have characterized as an overall "reckless approach to rulemaking."

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(Continued from P.1.) HFSC Republicans have also been vocal about what they perceive as a Gensler-led campaign to stymie legitimate oversight requests, accusing the Chairman of "consistently and knowingly fail[ing] to be responsive to requests from Congress." To that end, on May 10, McHenry, along with HFSC Oversight Subcommittee Chairman Bill Huizenga (R-MI), sent a letter to Gensler demanding that the Commission "produce outstanding documents previously requested by the Committee, including information related to charges recommended against FTX founder Sam Bankman-Fried, the SEC's disastrous proposed climate disclosure rule, and registration information for digital asset entities." The letter warned that "Should the SEC fail to produce the recommendation memo and its supporting evidence and documents before Friday, May 19, 2023, the Committee will schedule testimony from the Commission's Legislative Affairs and Office of the General Counsel teams to examine their failure to comply with congressional requests."

> **"Your move, @GaryGensler."**
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> **- HFSC Chair Patrick McHenry, after announcing back-to-back SEC oversight hearings for June 22.**

(Both of next week's hearings will be held on June 22nd. The first hearing, entitled "Oversight of the SEC," will be held by the Subcommittee on Oversight and Investigations chaired by Rep. Huizenga. The second hearing, entitled "Oversight of the SEC's Division of Trading and Markets," will be held in the Subcommittee on Capital Markets, chaired by Rep. Ann Wagner (R-MO). The witness lists for both the hearings have yet to be publicly announced.

Top Policy Developments:

Senate Banking Committee Announces Legislative Markup; Sens. Brown, Scott Reach Agreement on Bill to "Hold Bank Executives Accountable for Failures." On Thursday evening, Senate Banking Committee Chairman Sherrod Brown (D-OH) and Committee Ranking Member Tim Scott (R-SC) announced that the Banking Committee will hold its first legislative markup of 2023 on June 21st. In the same press release, the Senators announced that they have reached an agreement on legislation that will "protect the American taxpayer and hold senior executives of failed banks accountable by clawing back their compensation, penalizing them for their misconduct, and directing banks to strengthen corporate governance standards. According to a section-by-section summary of the new legislation posted to the Committee's website, the new bill, entitled the *Recovering Executive Compensation Obtained from Unaccountable Practices (RECOUP) Act*, includes provisions intended to (1) strengthen the banking agencies' ability to remove or prohibit senior executives who fail to effectively manage the risks and governance of their banks; (2) require banks to include governance and accountability standards in their bylaws; (3) provide the FDIC with the authority to clawback certain compensation from senior executives at failed banks, including profits made by selling the bank's stock; and (4) increase and strengthen penalties against bad actors. As part of the markup, the Committee also plans to consider a separate sanctions and anti-money laundering bill aimed at combating the country's fentanyl crisis by targeting the illicit fentanyl supply chain.

House Republicans, citing "long series of abuses," announce legislation to "restructure the Securities and Exchange Commission and remove Gary Gensler as Chair of the SEC."

On June 12th House Majority Whip Tom Emmer (R-MN) and Rep. Warren Davidson (R-OH) appeared to make good on a threat issued in April by introducing legislation to restructure the SEC and remove SEC Chairman Gary Gensler from his position atop the agency. The legislation – H.R. 4019, the SEC Stabilization Act of 2023 – would redistribute power from the SEC chair to other commissioners, add a sixth commissioner to the body so the agency is split evenly between Democrats and Republicans, and create an Executive Director position to oversee the agency's day-to-day operations. According to a press release announcing the bill's introduction, the legislation aims to remedy "a fundamental flaw in the SEC's structure." Specifically, the sponsors assert the bill will correct a "concerning level" of authority that current law vests in the SEC's Chairman, thus rendering "the other four commissioner positions effectively redundant." By "forc[ing] commissioners to work together prior to approving any significant actions under the SEC's purview," the bill's sponsors contend that H.R. 4019 will "protect U.S. capital markets from any future destabilizing political agenda."

Reps. Emmer and Davidson are among the SEC Chairman's staunchest critics in Congress, and their bill stands little chance of becoming law. However, both men are members of the House Financial Services Committee, and Rep. Emmer's position as Majority Whip suggests that there is possibility that the bill could eventually reach the House Floor. Notably, however, HFSC Chairman Patrick McHenry (R-NC) is not a cosponsor of the bill, nor has he done or said anything to indicate support for the proposal.

The timing of the bill's introduction – one week after the SEC's announcement of major enforcement actions against the preeminent U.S. and international crypto platforms – reflects bitter frustration with Gensler felt by some Republican supporters of the cryptocurrency in Congress, who view the SEC not only as hostile to crypto, but intent on sidelining Congress in the ongoing debate about how digital assets should be regulated and policed, and whether a new regulatory framework is necessary.

Perhaps the most revealing aspect of Monday's announcement was the sponsors' acknowledgment that the bill "would implement a similar structure to that is currently in place at the Federal Election Commission," a famously weak agency, perennially incapable of action on significant issues due to deadlocked commission votes thanks to its 3-3 bipartisan structure.

Comment Window Closes on SEC Proposal to Re-define "Exchange" as House Republicans Demand Proposal be Withdrawn. June 13 was the last day of the comment period on the SEC's proposed change to a rule made under the Securities Exchange Act, widening the definition of an exchange to include a broader scope of trading platforms. The Commission initially proposed the amendments in January 2022, but reopened the comment period in May 2022. The proposed rule amendment would bring what the SEC calls "communications protocol systems" (CPS) within the definition, sweeping DeFi, or decentralized finance protocols, under the regulator's authority. In a last ditch effort to derail the proposal, all Republican members of the HFSC—led by Chairman Patrick McHenry (R-NC)—sent a letter to the SEC demanding that it rescind the proposed rule on the grounds that it exceeds the agencies statutory authority and runs contrary to the SEC's missions to protect investors and promote capital formation. In the letter, the lawmakers also assert that the SEC's proposed rule will "stifle innovation and harm digital asset market participants and the U.S. economy more broadly."

Congressional Developments:

Senate Democrats Extend Pressure Campaign on Mobile Payment Apps, Focus on Venmo.

Four Democratic members of the Senate Banking Committee on Thursday wrote PayPal CEO Dan Schulman this week to request information regarding "how Venmo has allowed fraud and scams to proliferate on its platform and the steps that Venmo takes to keep users' money safe." Citing "reports of widespread fraud and scams on Venmo," including a Consumer Reports survey showing that 9% of frequent users of p2p apps were victims of fraudulently induced transactions, and 12% accidentally sent money to the wrong person, the Senators requested information about "specific steps you are taking to detect and prevent fraudulent transactions, including fraudulently induced transactions, on Venmo."

Transaction volume on Venmo and similar p2p (peer-to-peer or person-to-person) apps, was an estimated $893 billion last year, and is projected to reach $1.6 trillion by 2027. June 2023 CFPB data estimates that more than three-quarters of adults in the United States have used a payment app. Despite their explosive growth in popularity, however, many consumer protection rules applicable to checks or to other types of electronic payments have yet to be updated to encompass p2p transactions, leaving decisions about risks to consumers to the discretion of the industry.

The letter, signed by Senators Sherrod Brown (D-OH), Jack Reed (D-RI), Bob Menendez (D-NJ) and Elizabeth Warren (D-MA), marks the latest salvo in year-long pressure campaign seeking to call attention to the lack of consumer protections surrounding the rapidly growing p2p payment services industry. Senate Democrats have sent similar letters to other large p2p platforms, including notably Zelle, a similar platform owned by many of the largest U.S. commercial banks.

The Senators requested that Schulman respond to their questions by June 30th.

McHenry Scolds FSOC on Non-Bank SIFI Designations. On June 13, HFSC Chairman Patrick McHenry (R-NC), sent a letter to Treasury Secretary Janet Yellen expressing "strong concerns with actions taken by the Financial Stability Oversight Council (FSOC) this past April seeking to make it easier to subject nonbank financial companies to prudential supervision by the Federal Reserve." McHenry's concerns relate to the FSOC's decision on April 21 to issue for public comment a proposed framework for designating firms as systemically important. The proposal — which the FSOC has been reconsidering for some time — would roll back a guidance approved in 2019 under the Trump administration that made nonbank designation significantly more difficult than it had been in the early years of the council, which was created by the Dodd-Frank Act of 2010. Firms designated as systemically important financial institutions, or SIFIs, would be subject to enhanced prudential regulation overseen by the Federal Reserve.

Banking Committee Progressives Urge DOJ to Investigate Binance for Lying to Congress. Senators Elizabeth Warren (D-MA) and Chris Van Hollen (D-MD) last week urged the Department of Justice (DOJ) to investigate whether cryptocurrency exchanges Binance and Binance.US made false statements to "a bipartisan group of Senators seeking information on the cryptocurrency industry in order to inform an ongoing legislative process and determine whether new laws are needed to address the risks from cryptocurrencies and cryptocurrency exchanges." In their June 7 letter to U.S. Attorney General Merrick Garland, the Senators accuse Binance of having "undermined [an] important investigation and the legislative process by providing false and misleading information to Congress…a potential violation of federal law that may subject company officials to fines and imprisonment." The Senators' request to the DOJ coincides with the SEC's filing of a complaint against Binance last week for "blatant disregard of the federal securities laws and the investor and market protections these laws provide." Binance.US launched in 2019 to serve US clients, while Binance Holdings is not authorized to transact with crypto customers in the country. The two entities have long maintained that they are independent of each other save for certain branding licenses and shared technology agreements, though the SEC's complaint alleges otherwise.

Regulatory Developments:

CFTC Commissioner Calls for the CFTC to Initiate Rulemaking on DCOs Engaged in Crypto or Digital Asset Clearing Activities. In a May 30 statement, CFTC Commissioner Kristin Johnson publicly called on the agency to conduct a rulemaking to further regulate firms that clear crypto trades. "I propose that the Commission initiate an Advanced Notice of Proposed Rulemaking on Crypto or Digital Commodity DCO Clearing Activities. This approach acknowledges the innovative features of novel crypto-commodity derivative products and the platforms that clear and settle these transactions. Such an approach would enable the Commission to engage in a comprehensive review of the new or potential risks that arise from clearing activities in the crypto-markets and formulate a proposed rule that effectively responds to the identified concerns."

Chopra Spars with Senators Over Credit Card Late Fees. CFPB Director Rohit Chopra this week defended his agency's proposal to lower credit card late fees against criticism from Republicans at a Senate Banking hearing. Republicans criticized the proposal, saying credit card issuers would find other ways to recoup the cost of late payments that would make loans more expensive or elusive for low- and middle-income borrowers. Credit card late fees are required by law to be "reasonable and proportional" to the cost the companies incur to collect the debt. The Federal Reserve established a threshold at which late fees would be assumed to meet the requirements of the law. The CFPB's proposal, announced in February, would lower that threshold from $30 for the first late payment and $41 for subsequent late payments to $8. The Bureau has estimated that excessive credit card late fees cost American families about $12 billion each year, and that the proposed change would save consumers $9 billion each year.

HFSC Republicans Press Treasury to Clarify Rumored Executive Order on Outbound Investment to China. On May 26, HFSC Chair McHenry and HFSC Oversight Subcommittee Chair Bill Huizenga sent a letter to Treasury Secretary Janet Yellen regarding Treasury's "imminent release" of an E.O. on outbound investment and raising concerns that the Administration "may transform CFIUS into a committee on foreign investment in the United States and China. Last week's letter follows an earlier letter McHenry sent Treasury last fall urging Administration to work with Congress on efforts to regulate outbound investment, as an Executive Order will not lead to a lasting China policy. In their letter, the Republican lawmakers express deep skepticism of such a move, noting that similar policies "not only failed to deter Moscow from its war in Ukraine, but also left targeted entities so unaffected that Treasury had to re-sanction them last year." The letter requests written responses to six specific questions.

Other Developments:

NASAA Urges Senate Leadership to Promote Trust in Our Public Capital Markets. In a June 15 letter to Senate leadership and members of the Senate Banking Committee, the North American Securities Administrators Association (NASAA) urged the Senate to reject House efforts to enact legislation "that would harm the public capital markets and preempt state investor protection laws to the detriment of entrepreneurs, small businesses, and individual investors."

> **"At the end of the day, all this legislation would do is reduce educational and compliance support for the very entrepreneurs and small businesses that state securities regulators presently are helping."**
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> **- NASAA Executive Director Joey Brady, writing Senate leaders on June 15 in reference to "capital formation" legislation passed by the House and House committees.**

Ways & Means Committee Advances Partisan Tax Bills Comprising "American Families and Jobs Act." On Tuesday, June 13, the House Ways and Means Committee approved three bills: the Small Business Jobs Act (H.R. 3937), and the Build It in America Act (H.R. 3938) by votes of 24-18; and the Tax Cuts for Working Families Act (H.R. 3936), by a vote of 24-16. The Republican led package is intended to address concerns of businesses regarding rising interest rates and limited deductions for research and experimental expenses. Committee Ranking Member Richard Neal (D-MA) characterized the package as a "scam" and "a plan to furnish favors to big corporations and special interests by repealing the Inflation Reduction Act's energy credits for middle-class families and stunting our climate goals."

In win for Investment Adviser trades, House votes to require SEC to redefine "small entity" under the Regulatory Flexibility Act. On May 30, the House voted overwhelmingly to approve H.R. 2792, the Small Entity Update Act. The bill, sponsored by Rep. Ann Wagner (R-MO), would require the SEC to take steps to reduce the regulatory compliance costs of small federally registered IAs by conducting a study to ensure that regulations placed on these businesses are not overly burdensome. Specifically, the SEC would be required to consider the amount by which financial markets in the U.S. have grown since the last time the Commission amended the definition of the term "small entity" under the Regulatory Flexibility Act (RFA), and how it should define the term to ensure that a meaningful number of entities would fall under that definition. The bill would require the SEC to conduct an identical study and adjustment to the definition of "small entity" every five years thereafter.

Upcoming Events:

1. House Financial Services Committee — Hearing: "The Federal Reserve's Semi-Annual Monetary Policy Report." June 21, 2023 10:00 AM
2. House Financial Services Subcommittee on Oversight & Investigations — Hearing: "Oversight of the SEC." June 22, 2023 9:00 AM.
3. Senate Banking, Housing, Urban Affairs Committee – Hearing: "The Semiannual Monetary Policy Report to the Congress." June 22, 2023 10:00 AM
4. House Financial Services Subcommittee on Capital Markets — Hearing: "Oversight of the SEC's Division of Trading and Markets." June 22, 2023 10:30 AM.

Recommended Reading and Podcasts:

1. "Yellen Says Bid to Decouple From China Would Be 'Disastrous'" — NYT
2. "The Issues with the P.G.A. Tour-LIV Merger Go Well Beyond Golf" — The New Yorker
3. "The Plutocrat VS. The Monopoly" — The Atlantic
4. "Lawsuit Seeking $14,729 Tax Refund Could Lead to Corporate Windfall" — WSJ
5. "Fed's Powell Suggested July Rate Rise Is Likely, Analysts Say" — WSJ
6. "Does the U.S. have too many banks?" — NPR
7. "Big Banks Could Face 20% Boost to Capital Requirements" — WS