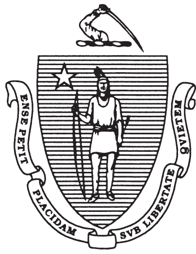

The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

April 25, 2017

Via Email

Chairman Jeb Hensarling
Financial Services Committee
2129 Rayburn HOB
Washington, DC 20515

Re: Comments in Opposition to the Financial CHOICE Act

Dear Chairman Hensarling:

I am writing in my capacity as chief securities regulator for Massachusetts to strongly oppose the Financial CHOICE Act ("Act").

While the preamble to the Act uses the language of hope, choice, and stability, the substance of the bill shows that such claims are entirely disingenuous. Numerous provisions of the Act will reduce transparency, expose retail investors to unjustified risks, and promote conflicts of interest that will harm retail investors.

It is apparent the Act is intended to be a gift to the investment industry and Wall Street special interests. A headline in the April 20, 2017 Washington Post noted that the Act is even more generous than the banks asked for. This is exactly the wrong path. We are still in the aftermath of the financial crisis; we must not forget the lessons that recent experience has taught us about financial abuse, conflicts of interests, and fraud. In a time of sweeping technological change and sophisticated financial scams, we must preserve and update our tools to fight financial fraud.

I understand that this bill will go through many iterations as it moves through Congress, and my office expects to provide more detailed comments during that process. This letter addresses three main points: (1) the need to protect the states' police powers relating to securities; (2) opposition to provisions that preempt state regulatory authority; and (3) opposition to language that would revoke the U.S. Department of Labor's Fiduciary Rule.

Protect State Police Powers To Act Against Financial Fraud

The Act is a direct threat to important police powers that allow the states to protect their citizens against fraud and financial abuse and that enable the states to avoid becoming havens for fraud.

State securities regulators would be severely hamstrung were Section 391 to go into effect. I strongly object to any language that dictates mandatory federal and state enforcement coordination, and the designation of a "lead investigative agency" that will head coordinated federal and

state investigations. Maintaining the independent authority of the states is especially important in light of language in the Act that has the effect of reducing the SEC's enforcement powers. Provisions that mandate state and federal enforcement coordination are just thinly-veiled attempts to similarly tie the hands of the states. Therefore, I urge that all references to state authorities be removed from Section 391 of the Act.

There is abundant evidence that the states have been uniquely effective early responders against securities fraud. The states have given consistent priority to the protection of mom-and-pop investors. The states are in close contact with their investors and with members of local business communities, and they have acted quickly to address investor complaints and initiate investigations. Having the states take a back seat during investigations that involve more than one agency would put more investors in harm's way for longer periods of time and thwart investor protection.

State securities laws enable the states to quickly stop frauds that are offered to investors within their borders and they permit the states to crack down on frauds that may originate from their jurisdictions, permitting the states to avoid becoming havens for fraud.

The healthy diversity of regulators at the state and federal levels reflects the federalism in our Constitution. Any attempt to yoke the states to the federal securities regulators would remove the great benefits now provided by the current system of parallel federal and state authority.

As my office stated in a White Paper[1] issued shortly after the 2008 financial crisis:

> "Such increased cooperation, information sharing, and coordination among federal agencies and state agencies would likely increase the consistency of investor protection efforts and lessen the likelihood of certain products and business conduct practices falling through the regulatory cracks. However, in order to protect the states' demonstrated and valuable role as the 'fail safe' protector of savers and investors, and to protect our nation's history of regulatory competition which has increased regulatory vigilance, **such cooperation must be promoted in a manner that does not compromise the independence and authority of state securities regulators**." (Emphasis added.)

I urge you to be vigilant to protect the reserved powers of the states to police securities fraud and securities law violators. Do not remove or blunt the tools that have allowed the states to effectively protect investors.

Examples of Successful Coordination Between State and Federal Enforcement Agencies

I acknowledge that cooperation and coordination between states and their federal counterparts is important. In the past few years, there have been many successful enforcement actions that were the result of cooperation and coordination between my office and federal agencies, and were not the result of mandatory coordination. The following examples show how states and federal agencies have worked together to help combat investor harm:

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[1] *States' Demonstrated Record of Effectiveness in Their Investor Protection Efforts Underscores the Need to Avoid Further Preemption of State Enforcement Authority*, White Paper, Office of the Secretary of the Commonwealth William F. Galvin (Dec. 10, 2008).

Multi-Level Marketing Case: Telexfree

In 2014, my office filed an enforcement action against Telexfree, a Massachusetts-based entity engaged in a multi-billion dollar pyramid and Ponzi scheme said to be the largest fraud of all time in terms of the number of people affected. The Telexfree scheme targeted primarily the Brazilian immigrant community. The Securities Division was at the forefront of a complex investigation that also included coordination with the SEC and the U.S. Department of Justice. Acting swiftly, my Securities Division was able to gather and preserve critical pieces of evidence, culminating in the first legal action against Telexfree. The quick action by the Securities Division exposed the scheme and alerted the public to the fraud, preventing further investor harm. The evidence gathered by my office was shared with federal regulators and proved crucial in the filing of federal criminal and civil charges. To date, federal and state authorities have identified over 950,000 victims from this notorious scheme in the U.S. and around the world, with combined losses totaling approximately $1.8 billion.

Ponzi Scheme: Stephen Eubanks and Eubiquity Capital

Last year, my office received a referral concerning a Massachusetts resident operating an unregistered hedge fund. The Securities Division immediately began collecting financial records and speaking with numerous investors. The Securities Division uncovered that the hedge fund operated as a Ponzi scheme, taking in over $500,000 from at least 30 investors, from Massachusetts and other states, resulting in investor losses of over $435,000. After filing a civil complaint to quickly halt the fraud, the Securities Division referred the matter to federal authorities, who recently secured a guilty plea to wire fraud from the principal.

Auction Rate Securities Market Failure

States led the charge in auction rate securities enforcement actions, which resulted in refunds of over $50 billion to mom-and-pop retail investors. Massachusetts, in particular, was out in front in this area. My office exposed conflicts of interest between financial institutions and investors and showed how those conflicts had a detrimental impact on the investors. For years, financial firms had propped up the auction rate market and marketed auction rate market securities to retail investors as “cash equivalent” and safe investments. Eventually, the same financial firms that had supported the auction rate market ceased to do so and the auction rate market froze. Investors were left holding these illiquid securities, which were anything but “cash equivalents.” State securities regulators and the SEC cooperated to negotiate investor refunds resulting in billions of dollars returned to retail investors.

Remove Language That Preempts State Authority

I urge that the following language, which preempts state regulatory authority, be deleted from the Act.

- Section 478(b)(1) of the Act should be amended to delete or relocate the words, “except that a State may not impose any fees under such authority.” This wording appears after language that explicitly preserves state enforcement authority. I am concerned that some may argue that the “no fee” language may be read to mean that states cannot impose fines for violations of law in connection with offerings that purport to be crowdfunding offerings. Because we believe that is not the intention of the drafters, we ask that the language be changed to remove that potential confusion.

- Remove state preemption language, “Exemption under State Regulation,” from the Section 461 exemption for micro offerings. This exemption could potentially be used to sell frauds of up to $500,000 without registration or even the filing of a notice with any regulator. It is important to preserve the ability of the states to have notice of these offerings and be able to police potentially abusive offerings.
- Remove from Section 476, Relating to Venture Exchanges, language in Section 476(b) that preempts state authority with respect to securities listed on such exchanges. Many of the securities on these exchanges will be high-risk penny stocks. This is an investment category where numerous retail investors have been harmed by fraud and manipulation, so it is important to retain state powers in this area.
- Remove Section 496, “National Securities Exchange Regulatory Parity.” As it is now drafted, this provision allows the SEC to designate any market or exchange as a “covered exchange” (state authority over the securities listed on such an exchange is preempted) without regard to the standards or quality of that exchange.

Objection to Revocation of the DOL Fiduciary Rule

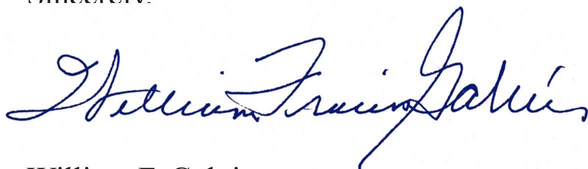
I urge that provisions of the Act that revoke the U.S. Department of Labor’s Fiduciary Rule be deleted from the Act. My office has conducted numerous enforcement actions relating to fraud and abuse in the sale of investments to retirement investors. Very often, investors are unable to recover from the grievous financial harm they suffer from such frauds. The Department of Labor’s Fiduciary Rule addresses a longstanding problem by requiring that any person providing retirement financial advice must act in the customer’s best interest. The adoption of the Rule represents a victory for retirement investors; I urge that the Rule be maintained and conscientiously administered.

Investor Protection Must Be Our Highest Priority

The Act purports to benefit Main Street and Mom and Pop. Instead, it is a generous gift to Wall Street and a grave threat to the interests of retail investors. Various provisions of the Act will have the effect of reducing the SEC’s rule making and enforcement powers; diminish or eliminate required disclosures; expose retail investors to high-risk segments of the securities markets, where they have often been hurt; reduce market transparency; and remove protections against severe financial conflicts of interest. I urge that you vote against the Act.

Please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, at (617) 727-3548, if you have questions or we can assist in any way.

Sincerely,



William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts