PROMOTING FINANCIAL STABILITY? REVIEWING THE ADMINISTRATION'S DEREGULATORY APPROACH TO FINANCIAL STABILITY

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C O N T E N T S

PROMOTING FINANCIAL STABILITY? REVIEWING THE ADMINISTRATION'S DEREGULATORY APPROACH TO FINANCIAL STABILITY

Thursday, December 5, 2019

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Sherman, Meeks, Scott, Green, Cleaver, Perlmutter, Himes, Foster, Beatty, Heck, Vargas, Gottheimer, Lawson, Tlaib, Porter, Axne, Casten, McAdams, Ocasio-Cortez, Wexton, Lynch, Adams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Wagner, Lucas, Posey, Luetkemeyer, Huizenga, Stivers, Barr, Tipton, Williams, Hill, Emmer, Zeldin, Loudermilk, Davidson, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Gooden, Riggleman, and Timmons.

Chairwoman WATERS. The Committee on Financial Services will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Promoting Financial Stability? Reviewing the Administration's Deregulatory Approach to Financial Stability." I want to inform all concerned that this hearing will end at 1 p.m., per the request of Secretary Mnuchin.

I now recognize myself for 4 minutes to give an opening statement.

Today, I welcome back Secretary Mnuchin. We are here to discuss the Trump Administration's actions that have undermined and not promoted our nation's financial stability. As I have said many times before, I am very concerned about this Administration's actions to eliminate important protections for consumers, investors, and our economy. It appears that our banking regulators are following the deregulatory blueprint that the Treasury Department, under Secretary Mnuchin's leadership, has mapped out point by point, and are rolling back many of the critical reforms Democrats made to prevent another financial crisis. If these rollbacks continue, there will be grave consequences for financial stability and our economy.

The 2008 financial crisis was devastating for our nation: 11 million Americans lost their homes; $13 trillion in wealth was lost;

and nearly 9 million Americans lost their jobs. As chairwoman of this committee, I am committed to doing everything that I can to ensure that we do not repeat the mistakes of the past, as I have now seen twice how the road of deregulation leads to financial crisis.

The focus of this hearing is the Financial Stability Oversight Council, or FSOC. We created FSOC as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act to eliminate regulatory gaps and to ensure the government could identify and mitigate risk to our economy. After the financial crisis, FSOC designated several large non-bank financial companies for enhanced oversight, including AIG, the well-known poster child for the financial crisis. Under the Trump Administration, however, FSOC ceased supervision of all of these non-banks, and advanced an activities-based approach that amounts to more deregulation, willfully ignoring how catastrophic the failure of a large financial institution would be for the financial system and the economy.

The Trump Administration also cut FSOC's budget and reduced its staff by half. It has also reduced the budget and staff of the Office of Financial Research (OFR), which collects data and conducts research and analysis to aid FSOC in its important work. Along the way, the Trump Administration has fleeced the American taxpayers with their tax scam, which contained more big giveaways to the nation's largest banks. All of these steps put Wall Street's bottom line first and Main Street back at risk. And make no mistake, the risks are growing. Climate change, cybersecurity, leverage lending, hedge funds, and the rapid emergence of big tech in the financial system, led by Facebook, are all concerns that must be taken seriously. Today, Secretary Mnuchin will also once again be asked to explain the harmful actions of the Trump Administration to the American public.

With that, I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 4 minutes for an opening statement.

Mr. MCHENRY. Thank you, Madam Chairwoman. And, Secretary Mnuchin, thank you for being here in your capacity as Chair of the Financial Stability Oversight Council, and I appreciate the work you are doing in leading the Financial Stability Oversight Council. I do also think that the timing of this hearing would have been more favorable if Members had been given more time to read your report that was released yesterday, but that is a timing issue here that we have to contend with. My colleagues on both sides of the aisle haven't had ample time to review the important work that the Council has done in this report.

So I think instead of just the political debate about regulatory changes that the Administration has done, I think this oversight of the Financial Stability Oversight Council is really important. The issue of stability, financial stability, and security is really important. Yesterday, prudential regulators testified before this committee on similar issues. During that hearing, I stated my concern with the transition from the reliance on the London Interbank Offered Rate (LIBOR) over to the Secured Overnight Financing Rate (SOFR). I think the issues that we have and concerns that we have there are about financial stability, and it is also magnified by recent Federal Reserve (Fed) actions in the repo market, that we could see more of at the end of the year. I also encouraged Vice Chairman Quarles to continue his review of the regulatory regime to ensure that safety and soundness and promoting economic growth are prioritized in their measures. And, I would like to hear your thoughts on the repo market as well. I think it is very important for us to hear from you on that.

But back to this question about LIBOR to SOFR, LIBOR's underlying bank reference rate is for about $200 trillion in financial contracts worldwide, and it is set to be phased out as a bank reference rate by 2021 and replaced with SOFR. Given the recent volatility in the repo markets, I am concerned about the subsequent volatility on mortgages, auto loans, business loans, and other consumer loans as a new reference rate is derived from secured overnight financing. Additionally, transferring LIBOR-based legacy contracts to SOFR will undoubtedly require financial institutions to renegotiate with customers. This is also an issue of financial stability and economic growth.

Finally, Secretary Mnuchin, I wrote to you last month regarding an issue that I believe is an alarming issue of potential consequence, and that is the financial transaction tax. This is not a honeypot of money that just comes from heaven. This will be a tax based off of buying or selling stocks, bonds, or other financial instruments that many are talking about as a new way to derive revenue for the Federal Government, and the rhetoric is that it will hit only the wealthiest. The reality is that average, everyday investors, especially mutual fund investors and those who are saving for retirement, will be severely impacted by this nefarious tax. And, in fact, one study indicates that a typical mutual fund investor will have to save an additional $600 per year or work an additional 2 years to achieve the same retirement goals. I would like to hear from the Financial Stability Oversight Council and from OFR on this matter. I think it is important that our government have an analysis of what this would do to our markets and our investors.

I look forward to your testimony, and I thank you for being here before the committee.

Chairwoman WATERS. I now recognize the gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, for 1 minute.

Mr. MEEKS. Thank you, Chairwoman Waters. Mr. Secretary, welcome. I will repeat to you what I stated to Governor Brainard and OFR Director Falaschetti when they testified at a hearing I chaired in September on financial stability. I was serving on this committee at the depths of the financial crisis, and I never, ever want to be put in a position again where the Treasury Secretary comes to the Floor of the House and tells us that we literally have days to save the U.S. economy from total collapse. I never again want to engage with constituents who are losing their homes and their life savings through no fault of their own, but because regulators and the Administration had completely lost track of systemic risk in the economy.

Mapping, quantifying, containing, and building contingency plans for systemic risk is not and should not be a partisan issue, and should not be a means for scoring political points. This matters to every American family who is saving for retirement, or to put a child through school, and I hope that we can do this in an intellectual, honest manner devoid of political partisan influence. I yield back.

Chairwoman WATERS. Thank you. I now recognize the subcommittee ranking member, Mr. Luetkemeyer from Missouri, for 1 minute.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman, and welcome, Secretary Mnuchin. I really appreciate you being here to testify today. Just yesterday, we had the prudential regulators before this committee discussing a myriad of issues—from regulatory rightsizing, to the Community Reinvestment Act, to future pending regulations—that the financial services industry is facinright now, as you well know. As you are the head of FSOC, which serves as the body where regulators come together to discuss overall financial stability, I am looking forward to discussing how FSOC is addressing the different matters affecting our financial system today.

Major areas of concern include Current Expected Credit Losses (CECL), cybersecurity, fintechs, the repo market, and LIBOR. All of these things will have a significant effect on both consumers and the economy and deserve the full attention of FSOC. I look forward to discussing these issues, and with that, I yield back the balance of my time.

Chairwoman WATERS. Thank you. At this time, I want to welcome to the committee our witness, Steven T. Mnuchin, the Secretary of the Treasury. He has served in his current position since 2017. Mr. Mnuchin has testified before the committee on previous occasions, and I believe he does not need any further introduction. Secretary Mnuchin, you will be recognized for 5 minutes for an oral presentation of your testimony. And without objection, your written testimony will be made a part of the record.

You are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF THE HONORABLE STEVEN T. MNUCHIN, SECRETARY, U.S. DEPARTMENT OF THE TREASURY, AND CHAIRPERSON, FINANCIAL STABILITY OVERSIGHT COUNCIL (FSOC)

Secretary MNUCHIN. Thank you very much. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for inviting me today to discuss the Financial Stability Oversight Council's 2019 annual report and other priorities of the Treasury Department. The report is the product of extensive collaboration among Council members, and I appreciate the hard work by the staffs of the Treasury Department and other member agencies. The report provides Congress and the public with the Council's analysis of financial and regulatory trends and its assessment of the potential risk to U.S. financial stability. It also provides recommendations to enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets.

Since the publication of the Council's last annual report in December 2018, the U.S. economy has continued to perform extremely well. Economic growth in the United States far exceeds our G-7 trading partners, and unemployment rates are near a 50-year low, including unemployment levels at or near-level lows for African Americans, Hispanic Americans, Asian Americans, and women. Wages are rising faster for hardworking families, corporate and consumer delinquency and default rates are low, and financial conditions remain stable.

This year's annual report discusses a number of risks we continue to monitor, but I want to highlight cybersecurity as one of the most important issues for the Council, regulators, and the private sector. Financial firms heavily rely on information technology, which creates great efficiencies for consumers and businesses, but also increases the risk that a serious cybersecurity incident could negatively affect the economy and potentially have implications for U.S. financial stability. We make specific recommendations in the report on this important topic including, among other things, that government and industry should work together to constantly update and share best practices to ensure that we are treating cybersecurity as a vital national and economic security priority.

The report also provides a strong message to market participants about the need to prepare for a transition away from LIBOR as a reference rate. Failure to prepare adequately could cause significant disruptions across financial markets and to borrowers, even the widespread use of LIBOR. We recommend that market participants formulate and execute transition plans that any new instruments that reference LIBOR should include fallback language to mitigate the risk in the event that LIBOR becomes unavailable. We also encourage financial regulators to evaluate the effects of new financial products on financial stability, including potential risks from digital assets and distributed ledger technologies. We will continue to use the Council's working group on these issues to promote consistent regulatory approaches to identify and address potential risks while promoting American leadership and financial services innovation.

Turning to another of Treasury's key priorities, we will continue working with this committee on meaningful housing finance reform to foster competition for the benefit of consumers, protect taxpayers from future bailouts, and facilitate a smooth transition for the Government-Sponsored Enterprises (GSEs) out of conservatorship. I am proud of the work we have done, with President Trump's leadership, to create a resilient, thriving, and prosperous economy. Thank you, and I look forward to answering your questions.

[The prepared statement of Secretary Mnuchin can be found on page 56 of the appendix.]

Chairwoman WATERS. Thank you very much. I now recognize myself for 5 minutes for questions.

Secretary Mnuchin, I want to go straight to a discussion about hedge funds. In November 2016, when the last public update on the Hedge Fund Working Group's progress was issued, FSOC outlined 5 date limitations that needed to be addressed to better understand the risk posed by hedge funds. At times, in the lead-ups to past crises, activities and losses in the hedge fund sector have proven significant leading indicators. For example, Bear Stearns' hedge funds with subprime exposure collapsed in the summer of 2007, signaling the impending subprime crisis.

When was the last time the Hedge Fund Working Group convened? Why has the working group not met more frequently during your tenure as FSOC's Chair? What is the status of the limitations identified in FSOC's last public update? Does FSOC now have access to the data previously identified in 2016 so that it can assess whether hedge funds are a source of systemic risk to the economy? If not, why hasn't FSOC taken any steps to address this information gap over the past 3 years?

This is very important. We have members of this committee who are trying to make some decisions about hedge funds. We have members of this committee who think there are some who are operating in good faith, but there are many who are not. We are worried about hedge funds that take over fire departments, and hospitals, and other city services. We are worried about hedge funds that take over fire departments and the response time is slowed down. We are worried about hospitals closing down. So why don't you talk to us about what you know about what is happening with the working group that was supposed to convene, and help us to deal with this issue?

Secretary MNUCHIN. Thank you very much. Let me first highlight that on page 94 of the report, we specifically talk about hedge funds. So, this is something that the staff is monitoring. Since we have moved to an activities-based approach as opposed to an industry approach, we are monitoring all of the activities that hedge funds participate in as part of our risk management. And one of the areas, in particular, we focused on that I know the committee has highlighted is leveraged lending. I also would say that fortunately, the hedge fund industry has de-levered significantly. But I appreciate your concerns, and we will continue to monitor carefully all of the activities of hedge funds.

Chairwoman WATERS. Can you make a distinction for us between the hedge funds and the private equity funds? Are they involved in the same kinds of operations and acquisitions?

Secretary MNUCHIN. Normally, they are not, Madam Chairwoman, and we do specifically also on page 94 break out private equity funds. The difference is that mostly, and, again, the majority of the hedge funds are in liquid markets, and the majority of private equity funds are buying companies or illiquid assets. And because of that, typically the private equity funds are structured as very long-term funds, and the hedge funds are normally subject to annual liquidity, which does create additional risk that we are—

Chairwoman WATERS. Thank you for that clarification. When was the last time the Hedge Fund Working Group convened?

Secretary MNUCHIN. I can check on that for you and get back to you, but as I suggested, we have really focused on activities. The activities are being monitored as opposed to specifically the Hedge Fund Working Group, but we will get back to you on that.

Chairwoman WATERS. Do you know the status of the limitations identified in FSOC's last public update?

Secretary MNUCHIN. Yes, and, again, as I have suggested, we specifically had a comment on hedge funds and private equity funds in the report, and that is something that the Council is focused on.

Chairwoman WATERS. Does FSOC now have access to the data previously identified in 2016 so that it can assess whether hedge funds are a source of systemic risk to the economy?

Secretary MNUCHIN. Some of that data we do have access to, and some of the data we have determined is no longer relevant.

Chairwoman WATERS. I yield back the balance of my time. The gentleman from North Carolina, Ranking Member McHenry, is recognized for 5 minutes.

Mr. MCHENRY. Secretary Mnuchin, as you well know, and as the FSOC report here notes, in the past few months we have seen significant volatility in the repo markets. And I know there is speculation about what sort of combination of things occurred that created this volatility. There is speculation that there is a combination of regulatory effects that are impacting monetary policy, and that there are regulatory and supervisory actions that are unduly disincentivizing banks that are required to hold cash at the Fed, from using their cash reserves when the market needs liquidity the most. The Office of Financial Research (OFR) is starting to collect data on repo transactions—that is a positive—and the Council directed agencies to undertake a focused review. So as the Chair of FSOC, do you believe the spike in repo rates signals a need to examine the overarching regulatory regime for potential risks to financial stability?

Secretary MNUCHIN. Let me first say we share your concern about those 2 days when there was a significant spike. As recently as yesterday, we had the Federal Reserve Bank of New York, which is responsible for market operations, give a present to FSOC. I have met with Chairman Powell multiple times. We have talked about this as recently as this morning. We have discussed in our weekly meeting making sure that the Fed is prepared for year-end activities so that there are ample reserves.

I think it was a result of many different issues that came together in one day, one of them being, as you have outlined, certain regulatory issues. Banks are required to have excess overdrafts for intraday, so this is not normal liquidity, but this is intraday liquidity. There was also the impact of the Federal Reserve holds the Treasury cash account. We had a large payment of taxes, so, effectively, you had money coming out of banks going into the Treasury account, which drained reserves. But I can assure you this is something FSOC is very focused on, and this is something that in my role as Treasury Secretary, Chair Powell and I are working together on.

Mr. MCHENRY. Okay. So along those lines, the impact of regulation can impact monetary policy. And in this circumstance, when you have Federal regulations demanding that banks hold assets, and then they believe they should not use those because of regulation, that becomes problematic. And so, I think a systemic review of this to ensure that that intraday activity can be dealt with adequately is really important. The Wall Street Journal highlighted the question of tax payments, that there was a deadline, and the timing of the deadline on tax payments had an implication for the market, as you just mentioned. On a going-forward basis, is Treasury reviewing some of those timing issues?

Secretary MNUCHIN. We are, and we are working very closely with the Federal Reserve, as I said, to make sure that there are ample reserves both associated with the Treasury cash accounts, and we are working with the bank regulators on what could have been regulatory issues that caused that spike during the day, without creating anything that provides longer financial risks.

Mr. MCHENRY. Thank you. And in 2019, again, in yesterday's report, FSOC outlined and highlighted that ending LIBOR's reference rate is a concern to financial stability, and recommends that member agencies work closely with market participants to identify and mitigate risks during the transition from LIBOR to SOFR. Do you believe that financial regulators are adequately prepared for this transition?

Secretary MNUCHIN. I can assure you that this is something that we are very, very focused on. It is a risk, as you have highlighted, and we have outlined. Yesterday, just as an example, Chair Powell, myself, Randy Quarles, and members of the OCC, the FDIC, and others met with 10 bank CEOs to specifically talk about this issue of LIBOR and the transition. We are working closely with the SEC because we are also very concerned about securities and how securities will transition in the role of trustees. We may need to come back to Congress at some point and suggest some regulatory language in law to deal with this, but I can assure you this is one of the top risks that we are very focused on.

Mr. MCHENRY. Thank you, and thank you for your response on my request on the financial transaction tax as well. We will follow up.

Chairwoman WATERS. Thank you. The gentlewoman from New York, Mrs. Maloney, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is recognized for 5 minutes. Oh—

[laughter]

Mr. SHERMAN. I believe your statement is accurate for at least a week.

Chairwoman WATERS. Why did you give me this?

[laughter]

Mr. MCHENRY. Madam Chairwoman, do you have an announcement?

Mrs. MALONEY. Thank you so much, and thank you so much for your leadership, Madam Chairwoman. And I want to thank the Secretary for your continued leadership and support of the Corporate Transparency Act, the Beneficial Ownership Act, that recently passed out of this committee with strong bipartisan support. It would not have happened without your support, so I wanted to thank you. Law enforcement in my home State of New York, and across the country, considers this bill to be their top priority to combat terrorism financing and to make us safer, so I want to thank you. I do not think it would have passed without your support. I am very grateful.

My first question concerns the Federal Reserve, which recently warned about the ballooning corporate debt, which sits at nearly $10 trillion. That is about half the size of our overall economy. And there is a particular focus on the growth of the near junk BBB bonds and the continued rise of leveraged lending. Personally, I am very concerned that a lot of this debt is being used for financial risk taking and stock buybacks. I am also troubled to see that in the CLO market, there has been a wave of downgrades, and there are questions as to whether there is enough data on the CLO market. So, I have two basic questions. First, does the FSOC have a grasp on the global leveraged loan market, and, specifically, who actually holds most of the outstanding CLOs? And second, other than monitoring, what is FSOC doing to keep the surge of risky corporate debt in check? Thank you.

Secretary MNUCHIN. First of all, thank you for your work on beneficial ownership and your acknowledgement of our contribution. We are currently working with the Senate, and we look forward to bipartisan support turning this into law.

Mrs. MALONEY. Thank you.

Secretary MNUCHIN. Specifically, as it relates to your issue, let me just first say that the leveraged lending market is something that FSOC is very focused on. We have had several presentations at FSOC. We have a group within FSOC of all the different regulators that are looking at this. It is one of the things as part of an activities-based approach that we are monitoring the risk. The first issue we have examined is what is the exposure in OCC and FDIC banks, and I am pleased to report that a lot of the leveraged lending has moved out of the banks market to the CLO market, as you have commented. The CLO market does have long-term capital associated with it. It is something that we are carefully monitoring. And I would also just comment, you are right, there has been a very large issuance of BBB bonds. I don't think that has been used for stock buybacks. Most of the stock buybacks have been done out of cash and not additional leverage, but we are monitoring the BBB market also carefully.

Mrs. MALONEY. Well, thank you. I want to make sure you use every tool available to understand their connectedness to our overall economy. You have recently talked about LIBOR and SOFR in our hearing today. Do you think that the recent issues in the repo market indicate that SOFR might be more volatile than anticipated? We have seen a lot of turbulence that has raised some questions about it.

Secretary MNUCHIN. No, I am concerned about the transition from LIBOR to SOFR, and that is something that we are very focused on because it is a regulatory issue, it is a technology issue, and it is a legal issue. As it relates to SOFR and the volatility in those 2 days, over a long period of time it would not have a big impact on SOFR. But the thing we like about SOFR is that it is a market that can't be manipulated. It is highly liquid, and it is demonstrated and calculated unlike the LIBOR markets.

Mrs. MALONEY. That sounds like it is a good move. My time has expired or is getting close to being expired, and I look forward to working with you to pass the beneficial ownership bill. Thank you. I yield back.

Chairwoman WATERS. The gentlewoman from Missouri, Mrs. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman. And, Secretary Mnuchin, thank you for testifying before our committee today. We have seen proposals to implement a financial transaction tax in both the House and the Senate. And in addition, a number of Democrat presidential candidates have either endorsed or are considering a financial transaction tax. These proposals would place taxes on financial transactions typically involving stocks and bonds and derivatives. This tax would result in fewer trades and would leave market participants to look for other ways to avoid the tax. This will both reduce capital gains taxes, and might lead to other forms of tax evasion. Additionally, a financial transaction tax has already been tried internationally, and the results have been very poor. In Italy, the tax just raised 159 million euros of a targeted 1 billion euros in its very first year. In Sweden, a tax was imposed in the 1980s, and by 1990, more than 50 percent of all Swedish trading had moved offshore to London.

While proponents of the financial transaction tax argue that it would only affect the wealthy, that is simply not the case. This tax would impact all investors, most specifically and including millions of Main Street investors, saving and investing in mutual funds, a retirement account, a child's education, or maybe a pension plan. Secretary Mnuchin, what sort of impact could imposing a financial transaction tax have on the U.S. financial system?

Secretary MNUCHIN. Thank you for raising that issue. I share your concern about this potential tax. I think, as you know, that the United States is the leader in financial services, in capital markets, and people come from all over the world to raise capital in the United States. So, I am very concerned that would destroy our capital markets, and that American holders of mutual funds would bear the majority of the cost. Mr. McHenry actually also inquired and wrote to us about this, and we have committed to do some work internally and on an interagency basis to study this to see if we can try to come up with some research on what the impact would be.

Mrs. WAGNER. Do you believe it would reduce liquidity?

Secretary MNUCHIN. As I said, I think it would be quite detrimental on many aspects, both liquidity.

Mrs. WAGNER. No, volatility. Market volatility.

Secretary MNUCHIN. I think we may have less market volatility here because we won't have a market here.

Mrs. WAGNER. Right.

Secretary MNUCHIN. As you mentioned, it will go to London, to Hong Kong, and to other places where we clearly don't want it to be right now.

Mrs. WAGNER. And how would this impact overall U.S. economic growth, Mr. Secretary?

Secretary MNUCHIN. It would be a burden on economic growth, and, more importantly, it would be a burden on all the American taxpayers who already pay taxes and hold mutual funds and have their savings and their retirement in mutual funds.

Mrs. WAGNER. There are millions, as I said, of Main Street, hard-working Americans in my own 2nd District of Missouri who would be greatly impacted by this. Could this tax result in fewer trades and lead market participants to look for other ways to avoid the tax, the kind of tax evasion that we have seen internationally in other countries?

Secretary MNUCHIN. I believe it would. It would move money offshore. It would disproportionately hurt pensions, 401(k)s, and people who are saving for retirement.

Mrs. WAGNER. Do you believe, sir, that the cost to the Treasury of issuing Federal debt could increase because of the potential increase in trading cost and the reduction in liquidity that would occur if this tax were, in fact, imposed?

Secretary MNUCHIN. If the tax were put on U.S. Government securities, it would clearly just raise the cost of the government borrowing. There is no question.

Mrs. WAGNER. So, Federal debt would even be affected by this?

Secretary MNUCHIN. It would.

Mrs. WAGNER. Thank you. I look forward to your study, and we do hope that FSOC will do more work and research so that we can be very clear before moving forward with a horribly regressive and detrimental financial tax like this. Thank you so much for your time, and I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you. The gentleman from California, Mr. Sherman, who is poised to become the next Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is recognized for 5 minutes.

Mr. SHERMAN. I thank the Chair. The gentlewoman from Missouri brings out a number of concerns about a financial transactions tax. There are pros and cons of that tax, but I did make a list of all the problems she had with the financial services tax, and every single one of them would be avoided with a wealth tax. So I will put you in touch with the academics on our side who are helping Elizabeth Warren produce—

Mrs. WAGNER. If the gentleman will yield, I can't wait for that debate.

Mr. SHERMAN. I will not yield, because I think we know where you stand on this.

[laughter]

A lot of questions divide us ideologically, and then there are the simple ones where we can do something important for the economy, and we just put it off and we put it off. And we ignore the fact that even if we get it done by the very last minute, we have caused a harm to the market. And a trillion here, and a trillion there, adds up to real money. We have LIBOR instruments out there relying on the LIBOR index to the tune of roughly $10 trillion, and the LIBOR rate will not be published, or may very well not be published, after 2021.

Mr. Secretary, you said in your opening statement, "We recommend any new instruments that reference LIBOR should include fallback language to mitigate the risk in the event that LIBOR becomes unavailable." Good, but that still leaves us with $2 trillion of the LIBOR-based contracts that will still be outstanding at the end of 2021. They have already been written, these LIBOR legacy instruments, and we can't amend these instruments without the consent of every participant. That is impossible. I am working on legislation that would solve this problem and link these LIBOR-denominated instruments to the secured overnight financing rate so far.

But it occurs to me you might be able to tell me that we don't need legislation. Does Treasury have the authority to issue regulations, or does any Executive Branch agency have the authority to issue regulations, to simply say if you have a LIBOR contract and it doesn't provide for a backup rate, here is how to do the calculations? And if you don't have the authority, do you want the authority?

Secretary MNUCHIN. Yes. First of all, again, let me acknowledge that I agree that this is a bipartisan issue. This is something we should work on. And the work on this predated me coming to Treasury, so this has been a long time. And as I mentioned earlier, we may come back to Congress and suggest that you pass legislation—

Mr. SHERMAN. I would ask you, this is not on your 2021 calendar. This should be on your December calendar or your January calendar.

Secretary MNUCHIN. I agree with you—

Mr. SHERMAN. I look forward to working with you. I need to know whether you need legislation. I need to know what you need, and we need to make sure that there aren't $2 billion of debt instruments outstanding where people cannot determine what interest is supposed to be paid. And I want to move on because I do chair the Asia Subcommittee for another week, and we focused on China. China could end up with $1.5 billion of World Bank loans. This is under discussion now. China's income has already exceeded the level where they should be eligible for these loans.

The Chinese government has enough money to put a million Uyghurs behind bars and to build a military complex that destabilizes the world. So it seems like maybe China should only be able to borrow money in the private markets at private market rates. Now, I know the United States won't support World Bank loans to China, but I am asking, what are you doing to stop those loans? Are we simply making academic arguments, or are we making it clear that our future involvement in certain World Bank activities is dependent upon not giving concessionary loans to China?

Secretary MNUCHIN. Again, thank you for raising this issue, which I also think there is a bipartisan consensus on. David Malpass, who is now the World Bank president, when he was working for me as Under Secretary, as part of our reforms package we negotiated with the World Bank, with the prior leadership there. We negotiated significant reductions in China lending with the path to get below $1 billion. They have been below $1 billion this year. Yesterday, we submitted our objection to the current country plan, so we look forward to following up with you.

Mr. SHERMAN. Thank you.

Chairwoman WATERS. The gentleman from Florida, Mr. Posey, is recognized for 5 minutes.

Mr. POSEY. Thank you, Madam Chairwoman, and Ranking Member McHenry, for holding this hearing on systemic stability. For many of us who grew up after the Great Depression, the first experience we had with severe systemic instability was the last financial crisis. At this time, we often watch the classic movie, It's a Wonderful Life, where we experience the drama of a run on the banks with George Bailey, the hero of the movie played by Jimmy

Stewart, who saves the small town savings and loan from the bank run. The last crisis taught us that we no longer live in the world of Jimmy Stewart banks. Runs on other financial system liabilities, like money market funds, may often threaten far greater consequences today than bank runs.

Markets for assets make a lapse in dramatic ways and destroy the ability of financial institutions to fund their assessment holdings and meet the survival constraints imposed by liquidity and even solvency. We often hear the words, "you can't be too careful," but the reality is that in recognizing our financial system, we can be so careful that we stifle its innovation, restrict credit and finance, slow economic growth, and inhibit jobs for people. We must strike a balance between the risk of return, and we must look to those balanced solutions to keep our economy on a path towards sustained growth. Mr. Secretary, please let me commend you for your leadership in working with other key regulators to finalize reforms related to the proprietary trading provisions of the Volcker Rule. Thank you.

As you know, our banking history was different from banks, where banks focused on trade capital and played a limited role in long-term capital markets. In this country, banks always had a role in capital markets and the investments that made our economy a mighty engine of growth, the intercontinental railroad, shipping, and a host of other industries. I believe banks have a key role to play in venture capital, and the Volcker Rule is restricting that vital function. I recently joined other members of this committee in sending a letter to you and other key stability regulators asking that you move quickly to issue a proposed rule to amend the covered fund provisions of the Volcker Rule. Specifically, we asked you to revise the overly-broad definition of a "covered fund" to exclude venture capital and other long-term funds.

Mr. Secretary, this statute makes you, as Chair of FSOC, responsible for coordinating rulemaking. Are the financial regulators and the Department of the Treasury working on changes to the covered funds provision? And if so, could you please provide us with an insight on the timing for such a proposal?

Secretary MNUCHIN. Thank you. First, let me just acknowledge what you said, that a healthy banking system is critical to our economy, and our banks have de-risked and built up significant amounts of capital. So, the regulators have already made some proposed changes to the Volcker Rule that won't create undue risk, but will create more liquidity in certain markets. And we are working with them, as you suggested, on the covered fund issue as well. Thank you.

Mr. POSEY. Any idea what the timeline would be on that?

Secretary MNUCHIN. I would hope it will be over the next 90 to 120 days, but we will get back to you.

Mr. POSEY. Do you expect much criticism in that regard?

Secretary MNUCHIN. I am not going to speculate, but any proposed rulemaking will be open to public comment, and we will take those comments into consideration.

Mr. POSEY. Very good. I wanted to talk about some of the climate change regulations, but I only have a minute left. And I just wondered if you could give me your assessment on the usefulness of taking the short-term stress testing discipline into a much longer period realm of climate change. Does that make any sense to you?

Secretary MNUCHIN. It does not. I'm sorry. Can you repeat your question? I want to make sure I heard it correctly. I said it does not, but I want to make sure.

Mr. POSEY. I just wonder what your assessment is on the usefulness of taking the short-term stress testing discipline into the longer-term realm of the climate change requirements?

Secretary MNUCHIN. Let me just say that I have vast expertise on a lot of different things, but climate is not one of them, but I think the banks have a difficult enough time on modeling different risks. I think long-term climate risk is something that is subject to a lot of different views, and as long as there is proper disclosure, I think that is adequate.

Mr. POSEY. Very good. I thank you, and my time has expired. I yield back.

Chairwoman WATERS. Thank you. The gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. Mr. Secretary, I think that we can agree—as I said in my opening statement, I am really concerned. It was one of the things that shocked me as a Member of Congress when Secretary Paulson came on the Floor talking about how our whole economy was going to drop. And so with FSOC, we are trying to look forward to try to figure out what is going on and what will happen in the future. I have some real concerns because, as I look at the Chinese growth stalling, as I look at how the European economies are slowing, with some entering recession, I look at Brexit looming and what effects that Brexit may have, and then all of the turmoil that is going on in Latin America, it gives me real concerns. And when I look at some of the forecasts, America and the U.S. economy is slowing also.

History may not repeat itself, but sometimes it certainly rhymes, and I fear that over the next few years, for the economy it may rhyme a little too much for me with the past decade. And so I am hoping that the Administration is going to look well ahead of what takes place and have certain formulas that they put in place in case there is a tremendous problem, like when I look at the debt stock of corporations, and even colleges and universities, has ballooned. An important share of this debt is in the form of leveraged loans and covenant-lite loans. And there seems to be a real risk of a downgrade cliff, and that a growing share of this debt is just barely above junk.

I am hoping—do you have some models to show what would happen to employment, homeownership, and the broader economy if these loans were downgraded loans en masse in the event of a downturn in the economy? And also, what would it affect and how would it affect the retail sector, for instance? Is there any model that you have? Can you tell us, because I am really concerned about these leveraged loans that are out there?

Secretary MNUCHIN. First, let me just say we share your concerns on financial stability. I worked for Secretary Paulson for a long time, and I speak to him regularly, and I hope we are never in that type of a time period again. Specifically as it relates to leveraged lending and covenant lite, we do share your concerns. We are monitoring those risks. Those are the types of activities we are carefully looking at. We have studied it very carefully as it relates to the banks, and, again, we are very comfortable that there is very limited exposure in the banks. As it relates to specifics of the impact on employment and retail sales and other areas, we will get back to you on our thoughts on that.

But, again, my view is that it is minimal because the exposure is outside of the banking industry and shouldn't have the type of contagion and risk that occurred during the financial crisis.

Mr. MEEKS. Thank you for that, and I do get concerned sometimes, too, because now that it is outside of the financial or the banking system, we try to put certain things in place for the banking system so that we can make sure that see systemic risk before, and we could then make sure that we could downsize it to what was necessary. But outside where we may not, I want to make sure that we are watching what is happening on the outside also because I don't want this to catch us by surprise. I think that is tremendously important.

Secretary MNUCHIN. I agree, and I assure you we are.

Mr. MEEKS. Also, when I looked at what devastated me in this financial crisis, it is a reminder that recessions and crises don't hit all sectors and demographics of the economy equally. For example, if you look at my district, and Black and minority communities, they overwhelmingly lost wealth, lost jobs, and were foreclosed upon at disproportionately high rates, and many of them haven't fully recovered yet. In fact, minority banks failed at 2½ times the rates of non-minority banks, and they have also yet to recover. So, I was wondering, as FSOC considers systemic risk and the risk of financial disruptions, how much consideration is given to the manner in which the burden falls on low-income and minority segments of the economy, and how do you quantify this, and what has it done to seek to address this? You have 23 seconds to address this, if you can do it.

Secretary MNUCHIN. Sure. Let me make me two comments, and we are happy to follow up with you on another one. But one, housing reform is something we are very focused on, particularly because of the disproportionate impact on certain communities. And also on minority-owned banks, we have a program at Treasury, a mentorship program, that we are working on. But I look forward to following up with you.

Chairwoman WATERS. The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. First, I would like to thank the Secretary for responding to a letter that I and 20 of my colleagues sent to you recently regarding CECL. Looking at the minutes of FSOC's meeting yesterday, I can see that you directed OFR to examine all current research on the matter and report back. I think this will enable some light to be shed on the standard which I believe is detrimental to our industry as well as our consumers and our economy, and we are looking forward to following up with OFR just to make sure the process is conducted quickly. And I look forward to working with you on issues that I think are going to be pointed out by this research. So, thank you for doing that and responding to our request.

The first issue I want to talk about today is with regards to the new digital currency, Libra, that is being proposed by Facebook. We had Mr. Zuckerberg in here recently, and he explained his intentions and how this is all going to take place. Since then, China has made an announcement with regard to their own digital currency, and there have been some calls for the Fed to issue its own currency. And I would just like for you to give us your position on it, and where you see it going, and what your thoughts may be on it, because it does seem to have some legs.

Secretary MNUCHIN. Sure. Let me just comment that when people talk about digital currencies, it is a large, vastly different area, and different sectors have different things. Specifically as it relates to Libra, we have had probably a dozen meetings with Facebook. We have shared our concerns. It is part of the reason why they are slowing down their movement forward. We have discussed it at the G-7 and the G-20. If Facebook wants to get into digital payments, that is fine, and that may be good for their customer base and good for a lot of Americans who don't have access to banks. We want to make sure if they do it, they are doing it in a way that is fully compliant with our BSA/AML, and that in no way can this be used for terrorist financing and illicit activities.

Mr. LUETKEMEYER. Okay. But the Chinese have decided to get into this as well. And so the last half of my question was, there has been some thought process about the Fed getting into it and having their own digital currency. Is this something you see as necessary? Something you don't want to get into? Something that shouldn't be there? Where do you see this going?

Secretary MNUCHIN. Again, I would differentiate what China is doing from what a Bitcoin or a Facebook would do. What China is doing is really issuing digital currency in lieu of physical cash, and they can track all that, so they will be able to track where that goes. That is different than a Bitcoin. It is no different than in the U.S.—if money is sent on the Fed wire system, it can be tracked, and money through Swift has identifiers. So, again, I would differentiate kind of what central banks are doing from what a Libra or a Bitcoin is doing.

As it relates to the Fed, and Chair Powell and I have discussed this at length, I think we both agree for the near future in the next 5 years, we see no need for the Fed to issue digital currency. And that is because, again, we have a very sophisticated system. The Fed is working on an electronic payment system. We need to make sure there is a real-time electronic payment system in the U.S. But thank you for your concerns.

Mr. LUETKEMEYER. Okay. I appreciate the response. Yesterday, we had a hearing here in the committee, and there were a number of questions with regards to credit unions buying out banks. It seems that that is a little bit of a trend here in the last 12 to 14 months. In fact, the comment was made yesterday that I think there are 28 that have already been purchased this year with another 14 more in the hopper, I understand. The IRS is in your purview, Mr. Secretary. This means that those 28 banks, plus perhaps those other 14, are going to going to come off the rolls as taxpayers.

It is going to dent the Treasury sum, obviously not much, but some, and there doesn't seem to be any resistance from the standpoint of the FDIC and/or the credit union regulators to not allow this to happen.

So, it is continuing to be approved. It is continuing to happen. In fact, I was having a discussion last night with somebody, and they said, well, maybe the banks need to start buying credit unions, throw the charter out the window and become a credit union, and they can avoid taxes. I don't know if that is doable, but there are some people starting to think outside the box because they are looking at this as a tax loophole. From your standpoint, do you see concerns from the standpoint of credit unions buying out banks? Is this just another part of a merger situation that is going on in this country, or is there a trend? Is it a tax evasion situation? How do you view this?

Secretary MNUCHIN. We will follow up with the FDIC on this issue and monitor it. It is not something that has caught my attention because fortunately it is on still small scale. But I appreciate you raising the concern, and we will follow up with the FDIC.

Mr. LUETKEMEYER. This past week, there was an announcement of a $700 million bank that was bought out by a $10 billion credit union.

Secretary MNUCHIN. Yes.

Mr. LUETKEMEYER. So this is going to continue to grow, and it is going to be a concern, I think, that needs to be on your radar. Thank you for your response.

Chairwoman WATERS. The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Secretary Mnuchin, how are you? I want to make sure I am clear on your level of concern about the continued volatility in the repo market and its impact on the calculation of SOFR, the Secured Overnight Financing Rate, which, as you know, is a designated replacement rate for LIBOR. Now, I listened to your response to Mr. McHenry and also to the gentlelady from New York, and I want to be clear because I read your report, FSOC's 2019 financial stability report. Here is what you said: "Market participants with significant exposure to LIBOR remain vulnerable if they do not sufficiently prepare all the way to the end of 2021." What did you mean by that, and what did you mean by "prepare?" What are you doing to help the industry participants prepare?

Secretary MNUCHIN. Again, let me just emphasize two different issues that are related in a way, as you said. I am concerned about what happened in the repo markets. That is not just a concern for SOFR. That is a broader concern because we rely on these repo markets, and it impacts many, many individuals and institutions, so we have had active discussions with the Fed on that issue. That does impact the LIBOR transition, but the LIBOR transition is a much broader problem, and, as I said, as recently as yesterday, we convened a group of the banks and the regulators on this.

Mr. SCOTT. What did you mean by, "they will remain vulnerable?"

Secretary MNUCHIN. Well, if banks and trustees and security holders don't prepare for the transition, there are trillions of dollars that people could wake up in 2021—

Mr. SCOTT. And by "prepare," you mean to do what?

Secretary MNUCHIN. It is a list of everything from prepare technology so that they have the ability, prepare the legal analysis, prepare a transition. People literally have hundreds of thousands of transactions, and, as I said, part of this may be coming back to Congress and asking you to pass legislation in part of this because there may be serious legal issues that we are still exploring.

Mr. SCOTT. let's go overseas for a moment. I am very concerned about Brexit and the particular impact that Brexit will have on our businesses, on our financial markets, particularly because of the uncertainty we are seeing around the whole deal of delays after delays, and the failure of them to come up with a clean deal. So what I want to get from you, as our Treasury Secretary is, how concerned are you about this situation with Brexit and the impact that this uncertainty is having on our cross-border transactions with our financial market participants?

Secretary MNUCHIN. I would say that I am moderately concerned. I have been discussing this issue for the past 3 years with my counterparts at the Bank of England as well as the regulators, and the finance minister who is the Chancellor of the Exchequer. It is a significant risk to the U.K. It could have carry-on risk to the U.S. We are working with the regulators on those risks. We have managed through some of those, and some of those are still open. But as I have encouraged the U.K., they need to resolve this one way or another.

Mr. SCOTT. Also in your report, concerning that, you highlight the potential for risk and that they will have significant spillover effects in the United States, should there be a no-deal Brexit, particularly with regard to the cross-border transactions. What did you mean by that?

What would be the potential with no deal? What would be better for us or worse, no deal or deal, in your mind?

Secretary MNUCHIN. Let me just say I respect the people of the U.K. They can decide whether they want to be in Brexit or they don't want to be in Brexit. The risk is making sure that whichever case, there is a coordinated transition.

Mr. SCOTT. Thank you, Mr. Secretary.

Chairwoman WATERS. The gentleman from Oklahoma, Mr. Lucas, is recognized for 5 minutes.

Mr. LUCAS. Thank you, Madam Chairwoman.

And thank you, Mr. Secretary, for appearing before this committee one last time before year's end.

Secretary Mnuchin, in the Council's annual report, it recommended that the government and the private sector should have more effective information-sharing practices. Could you expand on how agencies can best work with financial institutions to address cybersecurity concerns without inhibiting the growth of emerging technologies?

Secretary MNUCHIN. As I highlighted in my opening comments, cybersecurity is one of my most important priorities. While I think the industry is well-prepared, we can never be prepared enough. The bad people continue to operate. We need to make sure that our financial markets are not only protected for today, but are protected for the future. And it is a coordinated response between private companies, public companies, and the intel community, as well as the Treasury and the regulators.

Mr. LUCAS. Mr. Secretary, in what ways is FSOC and its members educating the general public on cybersecurity risk, particularly, as you noted, those coming from bad actors and bad actors abroad, too?

Secretary MNUCHIN. Our focus is less on educating the general public and more on making sure that the banks are educated, that they have the best practices. The general public will be protected as long as the banks and the financial system is protected, and that is what we work on every single day.

Mr. LUCAS. One last question, and I am thinking of my colleague discussing Brexit for a moment. You are in a unique position, with your finger on the national economy, a businessperson of much experience. Could you speak for a moment about potentially how much better the United States-Mexico-Canada Agreement (USMCA) deal is for American workers and why it is essential for the economy that we act swiftly on that in this body?

Secretary MNUCHIN. Yes. First of all, let me say I hope that Congress passes that between now and the end of the year. I know Ambassador Lighthizer, the Speaker, and others are working closely on this, and this will be a terrific win for American workers, and for the American economy.

Our largest trading partners are Mexico and Canada. These economies are interlinked. This is a great step for growth.

Mr. LUCAS. Thank you, Mr. Secretary. And with that, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much. The gentleman from Colorado, Mr. Perlmutter, is recognized for 5 minutes.

Mr. PERLMUTTER. Mr. Secretary, it's good to see you.

My questions are going to go back towards the repos, the repurchases, because there are some red flags here. Last year, banks had the most profits they have had in forever, in part because of the big tax cuts and stuff like that, but huge profits. And at the same time, we saw the excess reserves of the banks decline by 35 percent since 2017, and at the same time as the Fed and Treasury were sort of shrinking the balance sheet, all of a sudden over the last few months have had to expand it again.

I don't understand how those all come together, and if you could try explaining that again, I would appreciate it. Because we have big profits, shrinking reserves, and now expansion of the balance sheet again.

Those are the kinds of things that I think we have FSOC in place to monitor. What is it that is really driving this on a bigger scale, if you could tell us?

Secretary MNUCHIN. I am happy to address it again because it is a very important issue, and I don't want to minimize it. Again, as recently as yesterday at FSOC, we had a presentation from the Federal Reserve Bank of New York. I think there are a lot of different issues that came together on those 2 days that caused the spike. It was not any one single issue. But we are studying it carefully to make sure that this doesn't occur again and to make sure it doesn't occur on a prolonged basis.

The banks are having very good profits mainly because the U.S. economy is performing very well. I don't think this has to do with an issue of bank profits. This has to do with an issue of bank liquidity. The banks had plenty of liquidity. The banks had enough liquidity to go in and take up the repo, but they didn't want to do it. And the reason they didn't want to do it had to do with different regulatory tests that fit together.

So, the liquidity test was fine. It was different ratios that they were worried about hitting and tripping. So, again, this was partially a Treasury issue of Tax Day. It was partially a regulatory issue. It was partially a reserves issue.

And then just to comment, as you said, the Fed has been shrinking the balance sheet, which I think makes sense because as they went out of quantitative easing, they didn't need a giant. That was for the financial crisis. And what they are doing now doesn't impact the growth of the balance sheet by buying securities. It is really a cash management function around the repo markets.

But these are all very complicated issues that were intertwined, and we continue to work on them.

Mr. PERLMUTTER. But those were sort of the things that led up to the recession 10 years ago, that all of a sudden, there was this illiquid setting of our banks, and then everybody started getting nervous and the auction rate securities went to heck, and everything else started closing in. And I guess it just doesn't add up for me. We are making money over here, but all of a sudden, the reserves are shrinking like crazy.

We try to shrink the balance sheet, but now we are expanding it again. And it isn't just 2 days. It has been happening for several months now.

Secretary MNUCHIN. Again, I can assure you that the technical issues that happened around this have nothing to do with the financial crisis. The financial crisis was driven primarily by real losses in real estate markets, in highly leveraged securities. This issue is all about the government repo market.

And again, when we talk about the reserves at the banks, the excess reserves, most of those excess reserves are locked up at the Fed because of regulations that require the banks to have so much excess liquidity—

Mr. PERLMUTTER. But let me slow you down for a second because as we—I asked my staff to just kind of give me some numbers on student loans, on auto loans, and on corporate debt. We are at $1.6 trillion in student loans: 44 million Americans have student loans, with almost $30,000 as the average debt.

Auto loans were at $1.26 trillion: One hundred seven million Americans have auto loans, and seven million Americans are more than 3 months behind.

And corporate debt, we are at $10 trillion, $1.3 trillion in leveraged loans, $1.2 trillion in junk bonds. There is a lot of lending going on out there. And so the question is, are we getting overextended again? And that is what I am worried about.

Chairwoman WATERS. The gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Mr. Secretary, did you want to answer that?

Secretary MNUCHIN. Thank you.

What I was just going to comment on is I think it is a good thing that we have a lot of lending, a healthy economy. And again, I really do think that this bank issue is a highly technical issue, but it is something we are very focused on.

And student loans, that is a longer subject that we are studying carefully. We share certain concerns on the student loan market right now.

Mr. TIPTON. Thank you, Mr. Secretary, and I appreciate you taking the time to be here and speaking to that specific point.

The ability to be able to have access to capital, to be able to get this economy moving, and I think it is worthy of note that in the first 1,000 days that you have been in office with President Trump, you have been able to implement historic tax reform, and you have been able to take extraordinary steps to safeguard national security, making strides to being a better steward of taxpayer dollars.

And it is important to note that our free market system, with the help of tax reform and other deregulatory policies that have come out of Congress and the Trump Administration, has helped to be able to stimulate my State's economy in Colorado. In the past year alone, Colorado employers have created 43,800 jobs. Nearly 67,000 Coloradoans have found jobs. In fact, in my State, the unemployment rate is at 2.6 percent.

As you noted in your testimony, we are at a 50-year low on unemployment in this economy right now. We have policies that are actually making this capitalistic system work. Main streets in rural America is of primary concern to me. That is my district. And as you probably know, in many cases when we are looking at economic recovery after downturns, it is rural America that is last to come out of that recovery. And if another downturn comes, they are the first to be able to lead the way in to distressed economies.

And I am really pleased to be able to report to you that in my district, we are now starting to see property move in some of these rural areas. We are starting to see the economies move, jobs being created through the opportunity of our system, and I appreciate the efforts that you and the Administration have made to address that.

Would you agree, when we look at the overall economy—low unemployment, historic low unemployment in so many demographic groups that we have, the opportunity that we are seeing in this country—is this a good, positive sign for my State of Colorado and for America as a whole?

Secretary MNUCHIN. It is, indeed. And it is actually the bright spot of global growth.

Mr. TIPTON. And I think that is something that is going to be important for us as a Congress, as a nation, to be able to keep our eyes on. Despite some of this historic growth, we have some of our colleagues across the Capitol and in Governor's mansions across the country who are trying to upend our capitalistic system that has benefitted the majority of Americans in this country.

The economic engine that we have in this nation is something to be celebrated and to create those opportunities in front of us. We should not be pursuing socialistic policies to be able to redistribute income, to be able to slow that down, but rather, policies that are going to be making sure that every American has that opportunity to be able to reach their highest and best potential, as God has given them the ability to be able to do.

I would like to encourage you and the Administration to continue those policies that are creating opportunity for so many Americans, and to reject those that are going to be seeking to be able to redistribute income, to build out bigger government, more programs rather than empowering people with their own resources to be able to build for that bigger, better, and brighter future.

Again, I appreciate you taking the opportunity to be here today, and for your work on this economy, and I want to wish you and your family the best for the holidays.

Thank you, and I yield back.

Mr. PERLMUTTER. [presiding]. Thank you. The gentleman from Colorado yields back. The gentleman from Connecticut, Mr. Himes, is recognized for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for being here.

I would love to use my 5 minutes to have you reflect a little bit on shadow banking, and in particular the intersection of shadow banking and the mortgage system. I am of a tenure, I was sworn in, in January of 2009, when this committee wasn't sure that Citibank, for example, would remain solvent until probably a couple of quarters had gone by and all the implications. And of course, so much of that was due to irresponsible underwriting in the mortgage market.

In your report, which I have not had a ton of time to absorb, you actually make specific mention and, in fact, Box B, nonbank mortgage origination servicing, here the message is pretty clear, which is that nonbanks are now originating, it looks like more or less than half of mortgages, and those mortgages are disproportionately, significantly disproportionately going into the GSEs.

That makes me nervous because, of course, the GSEs are guaranteed by the full faith and credit of the United States and the American taxpayer. This feels to me like a little bit of a replay in which institutions that maybe don't have the underwriting discipline of banks are out there writing a lot of mortgages, sure that those mortgages will then be securitized.

I have sort of a general question, and then a specific question. My general question is, what sort of visibility do you think you and the other regulators have into the quality of the overall underwriting? And specifically, we spend a lot of time in this committee, and tried to reflect in Dodd-Frank, the notion of retention, meaning you actually eat your own cooking with respect to the underwriting.

And I have a suspicion that a lot of these nonbanks are actually not retaining exposure, but that, in fact, they are transferring it to the GSEs. So, generally, what kind of visibility do you have? And more specifically, are these nonbanks underwriting competently?

Secretary MNUCHIN. Let me say that we do have concerns, and that is why we have highlighted it. The good news is we do have visibility, and the main reason we have visibility, as you pointed out, a lot of these loans are being sold to the GSEs. A lot of these loans are being guaranteed by FHA. One of the things we want to do as part of housing reform is we are concerned, both at FHA and at the GSEs, that the underwriting criteria is deteriorating, and the loan-to-values are increasing. So, we are working with the FHFA and we are working with HUD on those issues.

The other area of concern that we have is that the mortgage servicing business, which used to be dominated by banks, is now dominated by nonbanks. And one of the problems is the nonbanks don't have the liquidity to advance on mortgages that the banks had. So, this is something that FSOC is very carefully studying.

I can also tell you, in my role on the FHFA board, we are studying this as well. I would say it is not at the point where we are nervous of the levels that it was 10 years ago, but it is a significant concern, and that is why we are carefully following it. And we will come back with additional recommendations, and I think there is a lot that both HUD and FHFA can do to cut down these risks.

Mr. HIMES. Let me follow up. You have a sentence here in Box B that says that loans originated by nonbank lenders have, on average, marginally higher debt-to-income ratios and lower borrower credit scores than those originated by banks.

So it feels to me—and again, I haven't had a chance to study this—like there is a little bit of an adverse selection going on here inasmuch as lower-credit mortgages are being guaranteed by the GSEs, but that the higher-quality mortgages are perhaps staying outside of the GSE structure. Am I right in inferring that from the report?

Secretary MNUCHIN. Not necessarily. What is occurring is because a lot of the loans that the banks are originating are being sold to the GSEs. But if you look at the loans that the banks are originating, they are better-quality loans than the nonbanks. So if you look at what the GSEs are buying, the higher loan-to-level are from the nonbanks, and we are concerned about that.

The good news is the bank regulators made sure that banks weren't originating bad loans and just selling them. So, that goes back to your original comments.

And by the way, these should be bipartisan concerns. These should concern all of us.

Mr. HIMES. No, no. I completely agree, and I am glad to see this focus. I would emphasize again just drawing on what it felt like. My own State of Connecticut has only now in the aggregate recovered economically from the impact of what occurred in 2007 and 2008. So I appreciate you highlighting this, and I hope that if you need us to help with GSE reform or whatever, that we will be involved rather than surprised.

And I yield back the balance of my time.

Secretary MNUCHIN. We do need your help on GSE reform. So, we look forward to working with you.

Mr. PERLMUTTER. The gentleman from Connecticut yields back. The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

It's good to have you here, Mr. Secretary. Full disclosure again about me—car dealer, retailer, Main Street, and Texas. And I want to thank you for taking time out of your busy schedule to come up here to answer these questions.

By my count, this is the fourth time that you have appeared before this committee, and I know I have asked you this question before. But this is politics, and things up here in Washington seem to change hour by hour and minute by minute. So before I continue with my questions, I must ask you again, are you a capitalist or a socialist?

Secretary MNUCHIN. I am pleased to report I am still a capitalist.

Mr. WILLIAMS. And I am pleased to hear that. Thank you.

Now while our country is moving in the right direction economically, I am worried that we are not paying enough attention to the national debt, which recently surpassed $23 trillion. The net interest payment on this debt is estimated to reach around $400 billion during this fiscal year and could account for over 10 percent of the GDP by the end of 2020.

Federal Reserve Chairman Jerome Powell stated in November that our debt is on an unsustainable path that will cripple our ability to respond to a recession. In addition to Chairman Powell's comments, I have heard from former senior military officers, including some who served at Fort Hood in my district, that our debt is one of the greatest national security threats that they see facing the nation.

So the fact is we need to cut government spending, and we need to get serious operating within our means. So, Mr. Secretary, can you elaborate on the threat that our mounting national debt has on financial stability?

Secretary MNUCHIN. I would say that today it doesn't have much of a threat because we are the reserve currency of the world, and I think relative to this side of the GDP, it is sustainable. But what I would say is we need to grow our revenues faster than we grow our expenses. And I think, as you know, when the President came in, he presented a balanced budget. He wanted to increase military spending and decrease nonmilitary to pay for it.

To get a bipartisan deal done, we increased both. I was part of this with Speaker Pelosi just negotiating the recent deal, but over time, we need to look at government spending.

Mr. WILLIAMS. It is no secret economic growth has been slowing throughout the world. The International Monetary Fund revised its global growth estimates down to 3 percent for 2019 when just 2 years ago, the world's economy was growing at a rate of 3.8 percent.

But even as the global growth slows, the United States continues to outperform other developed economies, as you have talked about today, across the globe. And I can tell you again, being in the retail business, being on Main Street America, business is as good as I have ever seen it, and I appreciate that. So, Secretary Mnuchin, what factors are contributing to our growth outpacing our European counterparts?

Secretary MNUCHIN. I think there is no question it is the economic policies of the Trump Administration. It has been a combination of tax cuts, regulatory relief, and better trade deals. And that is what we are focused on.

Mr. WILLIAMS. Unemployment currently, as we know, exists at 3.6 percent. And earlier this year, the top economist at Goldman Sachs predicted that this number could fall to as low as 3.25 percent by the end of 2020. So what concrete actions would you recommend we take in Congress to help make this prediction become a reality?

Secretary MNUCHIN. I would suggest you continue on bipartisan support of USMCA. That is the most important thing on the economic side the Congress can do between now and the end of the year.

Mr. WILLIAMS. I totally agree with you. Next, data security is one of the greatest threats to our financial system as our economy becomes more digital. Because of congressional inaction, many States have adopted their own data privacy standards. Unfortunately, for many businesses in my district, they are going to be forced to comply with various standards in order to operate their businesses in all 50 States.

I know you have addressed this before, but as it is important for the businesses in my district that we talk about this, what would be the value of having a single Federal data security standard?

Secretary MNUCHIN. I think it is something we should look at very carefully. Just as there are national banking standards, I think data is something that is very critical. And also, by the way, this is an issue on a global basis. We want to make sure that localization doesn't stymy growth in transactions.

Mr. WILLIAMS. Before I close, again, thanks for being here. I want to applaud the Treasury Department's work in standing up for U.S. interests during recent negotiations with European regulators over insurance capital standards. We cannot allow bureaucrats in Brussels to write unworkable rules and regulations that would hurt insurance companies in our country.

Keep up the good work, and I yield back the balance of my time.

Mr. PERLMUTTER. The gentleman from Texas yields back. The gentleman from Illinois, Mr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman, and thank you, Secretary Mnuchin.

There are so many new, emerging threats to financial stability today from cryptocurrency projects such as Libra, to ballooning levels of corporate debt, leveraged lending, and questions about the accuracy of ratings from bond rating agencies, in addition to climate-related risk, and the concentration of cloud services providers, just a very long list. And that is why I am very concerned that the Treasury's budget and staffing levels for FSOC and the Office of Financial Research have been greatly reduced under your watch.

Compared to the Fiscal Year 2017 budget, the Trump Administration's Fiscal Year 2020 budget would result in about half of the staff for FSOC and OFR. So, Secretary Mnuchin, do you really think that it is a wise idea to cut the FSOC and OFR staff levels in half?

Secretary MNUCHIN. I do. And the reason for that is because, one, you have been successfully increasing our Treasury staff outside of FSOC, as well as the other regulators. We rely upon one of the things that FSOC does is, I think it can have a smaller group of core people, and most of the work is done on a coordinated basis through all of the agencies. So, that is really why we are comfortable doing that, and we are trying to be prudent on expenses.

Mr. FOSTER. Well, it seems very short-sighted to me to cut the resources that are desperately needed to make sure that we even reduce the risk of the sort of financial crisis that we lived through.

So you are unwilling to commit to doing anything to restore those budgets. Is that correct?

Secretary MNUCHIN. I would never say I am unwilling to commit. We are happy to come up and explain to you what our thinking is. Again, we are just trying to save taxpayer dollars. We are not trying to do anything that would create more financial instability. If we thought we needed those resources, we would keep them.

Mr. FOSTER. Well, okay. I believe that we need to give FSOC and the OFR the funding and personnel they need to carry out what I regard as their very important missions, and that is why I have introduced the Enhanced Financial Stability Research and Oversight Act, which I am hopeful that we are going to be marking up in committee within a few weeks here.

This is a common-sense measure that just tries to restore the minimum funding levels that we had in 2017. It is pretty simple because we cannot foresee and prevent the next crisis if we do not have the personnel around to actually do the work, including the coordination of collecting the data, analyzing the risk, and performing the essential research.

Anyway, I just hope my colleagues will support me in this important effort. I think it is short-sighted to cut back those essential functions.

Now another point that I alluded to earlier is that, increasingly, big tech firms like Amazon, Google, and others are pushing into financial services and products, including cloud computing services for the largest banks. And according to a recent readout of the FSOC meeting, cloud computing was a topic of discussion.

My first question is, in your view, does FSOC have the authority it needs to designate a cloud provider as being a non-bank systemically important financial institution (SIFI) market utility?

Secretary MNUCHIN. At this point—and this is a very fact-specific situation—the answer is no. But it is something we have discussed at the FSOC and—

Mr. FOSTER. But do you have the authority? If you come to the conclusion that they should be designated, do you feel that you have the authority?

Secretary MNUCHIN. If we came to the conclusion.

Mr. FOSTER. Right. Okay. I have a real worry that the concentration of cloud providers—it would be an interesting thought experiment to say what happens if, for example, there was not too long ago a story on Bloomberg about the possibility that the Chinese had put little hardware bugs in very widely used equipment inside cloud utilities.

And so if that is discovered at a single cloud utility where they have to replace a big fraction of their hardware and have to be down for potentially months while that happens, to actually think what that would do to our economy if AWS went down for a month or two.

Secretary MNUCHIN. As I highlighted earlier, cybersecurity is a big focus of ours, and part of the reason why we are focused on the cloud is because we share your concerns. We want to make sure that no one financial institution is dependent upon, and would be taken down by, a cloud provider.

Mr. FOSTER. In my remaining time, I just want to thank you for your response to the letter that Congressman Loudermilk and I sent to you having to do with digital identity solutions. And I think that there is an essential government role there to leverage—as was the Administration's position—the REAL ID Act to allow citizens who wish to have a way to authenticate themselves in a secure manner online.

I think that is a fundamental necessity in a modern economy, and I think there is an essential job for the Federal Government to provision that basic identity and many opportunities for the private sector to leverage additional features on top of that. I want to thank you for your response, and I encourage you to continue.

I yield back.

Mr. PERLMUTTER. The gentleman from Illinois yields back. The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Secretary. It's great to have you back to the committee. I appreciate all of your leadership, and I just was so interested in listening today. And thanks to the regulators that we talked to yesterday for their swift implementation of S.2155 on regulatory reform. We appreciate Treasury's leadership on that.

In your work on strict sanctions around the world, in Venezuela, North Korea, Iran, and Russia, you have demonstrated a lot of leadership there. And of course, tax reform has been talked about extensively. So we are grateful for your leadership as our Treasury Secretary.

I want to turn and mention a couple of things that we have talked about today. On the repo market that Mr. Perlmutter talked about and the ranking member, I think the concern is that the New York Fed is not supporting the repo market, they are the repo market. I think that is the challenge.

And we don't see the bank reserves that are more than adequate, billions more than needed—on JPMorgan, for example, $120 billion in daily cash held at the Fed on a $60 billion cash requirement, and yet they are not entering that repo market. So I am pleased that yesterday at the FSOC meeting, you talked about this, because I do think supervision is an issue here. And the stigma attached with something that was a regular part of our business lives, which is running a daily, interday daylight overdraft at the Fed.

On mortgage servicing, I appreciated your comment there. Again, that business shifted out of the bank sector to the nonbank sector because of Dodd-Frank. And for the 5 years that I have served in Congress, I have tried to get the Obama Administration and the now Trump Administration to support the idea that mortgage servicing rights are not a derivative that should be treated in that manner.

It is, as you know from your long career in mortgage finance, a natural companion to the origination of residential mortgages. So I hope FSOC will lend its weight to allow mortgage servicing to not have the capital penalty that they have in Dodd-Frank.

Mr. Foster and I have had a lot of conversations about digital currencies. Fed Chairman Jay Powell just answered our letter on the idea of a digital token, and I think the concept is a little misunderstood.

If we want a digital future in finance and we want to protect the preeminence of the American dollar as the reserve currency, this idea of a digital token is an important concept. And it is not anything except allowing our government to facilitate a blockchain transaction process legally in the future.

We have Visa debit. We have Mastercard. We have Swift, Fedwire, the ACH system. All true, all have private sector participation in them and government participation. But this idea that there is a new rail created that is a blockchain rail that both banks and nonbanks can participate in to settle transactions through a token, it is coming our way faster than we like, perhaps faster than the 5-year timeframe you outlined. So I do think it is an important issue for the FSOC to continue to consider and also to have Treasury's view on, independent of what your agent over at the Federal Reserve thinks as you implement Article I's power on currency.

Let me turn and ask you a question about World Bank issues that we were—we had a hearing a few weeks ago at the subcommittee on that topic, multilateral development institutions. There was no Treasury representative; there was an illness that day.

And one thing I talked about in the hearing is the legislative mandates that are put on our managing director and our Governor to direct votes at the Fed. So my question to you, Mr. Secretary is, are you concerned that that kind of governance, to support or oppose a financing project, ties the hands of the United States in leading at the bank due to being forced to abstain on voting?

Secretary MNUCHIN. I am.

Mr. HILL. And does Treasury have an amount, a record of those abstentions? And that long binder, I understand, of rules that our Governor has to follow, and is that something you could share with the committee and help educate the committee?

Secretary MNUCHIN. We can come back to you on that. It is a huge bureaucracy running all these tests, and we keep the data, so we can get back to you.

Mr. HILL. Yes, what I hear, both from your former colleague, Mr. Mathis, and others is that it just reduces America's effectiveness to lead the bank. So I think we would be very interested in working with Treasury on a way to reduce those mandates, fine-tune the mandates, remove ones that are redundant, and have your leadership on that. Is that something you would be interested in helping us on?

Secretary MNUCHIN. We look forward to working with you.

Mr. HILL. Good. Thank you, and I yield back, Mr. Chairman.

Mr. PERLMUTTER. The gentleman from Arkansas yields back, and before I recognize the gentlelady from Ohio, I think we all want to wish the gentleman from Arkansas a happy 29th birthday.

[applause]

Mr. HILL. This is how I wanted to celebrate it.

[laughter]

Mr. PERLMUTTER. Okay. I would like to recognize now for 5 minutes the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you, Mr. Chairman, and Mr. Ranking Member. And thank you to our witness, Secretary Mnuchin.

Let me start out by saying thank you for the information that I received from you on working with your Office of Minority and Women Inclusion (OMWI) Director, looking at the diversity information, and that was very much appreciated. So, thank you.

Today, Mr. Secretary, I wanted to share with you that in yesterday's hearing with prudential regulators, several of my colleagues, including Congressman Cleaver, raised the issue of minority depository institutions (MDIs), specifically with the rate that they are disappearing. And as you know, since the financial crisis of 2008, the number of MDIs that fail is 31 percent.

At the end of 2018, we only had 149 of these institutions left. MDIs are incredibly important to the minority community that they operate in, and so I am introducing legislation today to codify the Treasury's Financial Agency Mentor-Protege Program, and it is known as the Expanding Opportunity for MDIs Act.

And I also want to say that it was just brought to my attention that your staff had sent my office some comments and technical assistance on the bill last night. So, I am very appreciative of that. Can you briefly describe what the Treasury's Financial Agency Mentoring Program will seek to accomplish and how your Department came up with it?

Secretary MNUCHIN. First of all, thank you very much, and we were glad to assist on this.

The Protege Program has worked very well, and the idea is to partner a minority bank with a large bank. And in that way, the minority bank can get resources and training and help to run their business.

We share your concern. I think there should be an increase in opportunities for minority banks, not a decrease. This is something I am pleased about. I personally wrote and asked many of the big CEOs to help on this, and we look forward to—I know we did work with you on some technical issues, and we look forward to continuing to help you on this.

Mrs. BEATTY. I want to say, thank you. Was there a specific need that you thought you had to send the letters to the big banks? Do you think it would help them to be more engaged to do it or because you felt they weren't doing anything?

Secretary MNUCHIN. No, they were pleased. I would say, when we asked people to go into this Protege Program, people have been very receptive, and it has worked. And we look to scale this up, and we look to work with you on your potential legislation.

Mrs. BEATTY. Well, thank you. Because we have noticed that some of the larger banks whom I have been very critical of, their lack of working, increasing enough with their CRAs, participating on diversity and inclusion. So I would like to say, Mr. Chairman and Mr. Ranking Member, people ask us all the time, why do you talk so much about diversity and inclusion, and it is beyond just hiring people because of their race or ethnicity or gender. It is also about, if you have someone in the room and you are mentoring and you are working with people, it helps with the economy. It helps with jobs.

Therefore, it crosses over that people can pay for their housing, because we have a lack of affordable housing. It helps them with healthcare. It helps them with daycare and childcare if they are in the room.

Again, I would like to say thank you, and Mr. Chairman, I yield back the balance of my time.

Mr. PERLMUTTER. The gentlelady yields back. The gentleman from Tennessee, Mr. Kustoff, is recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for appearing today.

We have had questions today about the U.S.-Mexico-Canada Agreement USMCA), and can I ask you, just in layman's terms, what is the effect to the economy if, in fact, Congress does pass the U.S.-Mexico-Canada Agreement? And conversely, what is the effect on the economy if we fail to pass the U.S.-Mexico-Canada Agreement?

Secretary MNUCHIN. I would say if we pass it, we estimated it is in excess of 50 basis points a year in GDP, which is very significant. This would create additional jobs. This would create additional revenue for the government, additional revenue for consumers and businesses, and it modernizes trade with our two most important trading partners.

I am not going to speculate on what would happen if you don't pass it, because I am highly encouraged that you will.

Mr. KUSTOFF. I would like to share your enthusiasm, and I appreciate that.

You received a question from Mr. Williams of Texas about the data localization and whether there should be a Federal standard. If I could, though, I would like to ask you about India. I know that you were recently in India, and we have read the press accounts about how India is trying to raise the bar as it relates to the data localization and, frankly, the restrictions on free trade as it relates to startups and other companies.

Can you talk about what the barriers are for U.S. companies operating now in India and what effect that could have?

Secretary MNUCHIN. Again, in my recent trip, we had very specific conversations. We have been dealing with them over the last year on this issue. We want to make sure that U.S. companies are treated fairly and can compete.

We have no issues if countries want to have local data for regulatory purposes, they do that. It is the issue of then eliminating data outside. And I think, as you know, we are in a global economy. We are in a scenario where data transfers. The data is processed in different places. So, this is a complicated issue that we continue to work on to make sure that our financial services companies are treated fairly.

Mr. KUSTOFF. Not only financial services companies, but also other companies that are operating in India as well?

Secretary MNUCHIN. That is correct.

Mr. KUSTOFF. And Treasury continues to work with the officials in India on that?

Secretary MNUCHIN. We do. And we are also working very closely with the Office of the United States Trade Representative (USTR) because it is a trade issue.

Mr. KUSTOFF. Thank you, Mr. Secretary.

We have talked about the benefits of the Tax Cuts and Jobs Act, which no doubt has been a tremendous benefit to our economy and to our folks who live in the Eighth Congressional District in Tennessee and across the country. One thing that we may not have gotten right in the Tax Cuts and Jobs Act is the Qualified Institutional Placement (QIP) as it relates to depreciation, and I think that is a technical fix, trying to resolve that.

Could you talk about the effect of trying to resolve that in terms of depreciation from 39 to 15 years?

Secretary MNUCHIN. Let me just say this is something that I hope this committee and others will help us with on a bipartisan basis. This was clearly a technical mistake, and what happened for retailers was due to literally a technical mistake in the drafting, the amortization became longer as opposed to shorter. And I think everybody acknowledges on a bipartisan basis that this was a technical mistake.

And this impacts an area of the economy, which is retailers. It is a big part of the economy. We have been trying to get this fixed. I would hope it is something that Congress, next year, will reconsider helping us work on. It was a simple mistake, and nobody is debating that.

Mr. KUSTOFF. From your standpoint at Treasury, is it something that should be resolved sooner rather than later, or you would hope would be resolved sooner rather than later?

Secretary MNUCHIN. It is our number one, two, and three technical fix request.

Mr. KUSTOFF. Thank you, Mr. Secretary. I yield back the balance of my time.

Mr. PERLMUTTER. The gentleman from Tennessee yields back. Mr. Heck from Washington is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

First, I want to join with my friend from Texas, Mr. Williams, in expressing my appreciation for the role that Treasury played in the international insurance negotiations. I happen to be one who believes that we ought to keep faith with the McCarran-Ferguson Act and that it is the best way to have a well-regulated, consumer-oriented insurance market. I think it has worked well. So, thank you, sir.

I am also grateful that my friend across the aisle raised the issue of the Tax Cuts and Jobs Act. I would like to ask you about it. Obviously, at the time, small technical fixes necessary notwithstanding—and I am a cosponsor of that bill. I hope as well that we get to it—that we were promised that it would be a game changer. Actually, those were your words.

This is going to be a game changer for business, and it was broadly held as something that would lead to increased business investment. It hasn't. There is the chart. That is the chart of the Bureau of Economic Analysis revealing that we basically had six quarters of a significantly downward trend of business investment and capital.

And I am going to ask you why you think that is, and what it is you think we ought to do about it, especially given the promises that were made. But I want to say, first of all, why I care about this.

I think it is pretty clearly established that there is a close relationship between increased productivity and increased wages. And let's face it, the data is in. We have been fairly stuck on wage growth for the better part of 30 years in this country, and while it is beginning to inch up, it is not really material in that increase.

Every upward trend is appreciated, but we still do not have wage growth. And presumably, we do not have wage growth because we do not have increased productivity, presumably because we do not have increased business investment, which we were promised. So, Mr. Secretary, why not, and what should we do about it?

Secretary MNUCHIN. First of all, I agree 100 percent with you on the impact of wage growth. That has been one of our priorities. I kind of disagree with you; I think it actually has been significant. I think that for the first time in the last 10 years, we have seen wages growing and growing at a level that is meaningful to taxpayers. I think we have also—

Mr. HECK. Would you care to cite the data, because it has not over consecutive quarters significantly outpaced the Consumer Price Index? And this is coming on the heels, I might remind you, sir, of basically 30 years of flatline.

Secretary MNUCHIN. Again, we are happy to give you the charts. But there is no question that wage growth has been increasing, and inflation has been very low. So, we are happy to get back to you with the data.

Mr. HECK. But the question is that downward arrow. We were promised an upward arrow. We haven't gotten it.

Secretary MNUCHIN. To be honest with you, I can't really read that chart, other than I can read the capital spending.

Mr. HECK. And do you see the blue arrow?

Secretary MNUCHIN. I got the blue arrow.

Mr. HECK. That is not good, sir.

Secretary MNUCHIN. I got the blue arrow. I will say—

Mr. HECK. That is business investment.

Secretary MNUCHIN. Again, I don't know how you are calculating that business investment.

Mr. HECK. I am not. The Bureau of Labor Statistics is.

Secretary MNUCHIN. Well, you have obviously picked a slide that demonstrates a dramatic decrease. We are happy to come back to you with our own data. Look, there is no question—

Mr. HECK. One of my favorite adages is that some people use facts and figures the way a drunk uses a lamppost to lean on, not to illuminate. I assure you, sir, I have not done that. This is the Bureau of Economic Analysis data. It is six consecutive quarters. I haven't in any way reshaped the bar graph or the line or the data in any way.

We are on a downward trend in business investment and capital equipment, even though we were promised, as a consequence of the Tax Cuts and Jobs Act, that it would flower. And we need it for increased productivity for real increases in wages. Why haven't we gotten it? You promised it to us.

Secretary MNUCHIN. Mr. Heck, first of all, we are the only economy in the world that is showing continued growth. That is not coincidental. We are showing additional jobs. We are showing wages—

Mr. HECK. Economic growth is 2 percent now.

Secretary MNUCHIN. Again, that—

Mr. HECK. That is what you are bragging about, a revised 2-percent forecast?

Secretary MNUCHIN. Those numbers, if you would let me respond, as opposed to screaming at me. Those numbers—

Mr. HECK. Oh, no, sir. If I am screaming at you, you will know it. This is not screaming.

Mr. PERLMUTTER. Gentlemen, please.

Secretary MNUCHIN. Those numbers were impacted partially by the Boeing impact. Those numbers were partially impacted by the strikes, and I would say they have also been impacted by a significant slowdown in global growth. And I think you are going to see growth quite significant in the pickup in the rest of the year and next year.

So, there is no question American taxpayers are seeing the benefit of tax cuts.

Mr. HECK. Thank you, sir.

Mr. PERLMUTTER. The gentleman's time has expired. The gentleman from Georgia, Mr. Loudermilk, is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman.

And Mr. Secretary, thank you for being here.

First, I want to thank you for directing Treasury to put America first, and for standing strong for American interests during the recent international insurance negotiations. I think, and I think you agree, that we must be very cautious about imposing European capital standards on U.S. insurers. I am glad Treasury has registered its official opposition. So, I want to thank you for that.

I would like to talk to you about the National Association of Registered Agents and Brokers, NARAB. In the 5 years that we have had NARAB, it has never been operational because the board of directors must be nominated by the President and confirmed by the Senate, and this hasn't been done.

And the last time you were here, we discussed that, and you committed that you would speak to the President about how important it was to get these nominations done. And I just wanted to follow up and find out where we are on that process?

Secretary MNUCHIN. We have put in recommendations, and it is going through the process, and we will follow up with you again, as we have suggested.

Mr. LOUDERMILK. Okay. And I appreciate that, if you could stay on top of it, because it is very timely. And I am concerned with the timeliness right now of the Senate because if we proceed with impeachment, as it appears we are doing, we are about to shut down the Senate for potentially 2 months or longer and not being able to get anything else done. So, I appreciate that.

I am also ranking member of the committee's Artificial Intelligence Task Force, and earlier this year, we had a hearing regarding customers' digital identity. And the task force chairman and I recently sent a letter to you, asking to move forward with some of the recommendations of the 2018 Fintech report, and I just wanted to find out what action Treasury has taken to work with the private sector on solutions to digital identity issues?

Secretary MNUCHIN. I think, as you pointed out, this is something that we identified early on. It is something that we continue to work on with the private sector. It is something I am also very interested in because of the IRS and from the government standpoint as well. So, it is something we look forward to continuing to work with you on. It is an important issue.

Mr. LOUDERMILK. Okay. I appreciate that, and if you could keep us up-to-date on progress that is made, that would be very helpful to us as well.

Also, in 2017, FSOC formed the Digital Assets Working Group, which is going to explore issues surrounding blockchain technology. I applaud you for doing that, but the one concern I have is that State banking regulators have been excluded from the working group. And Dodd-Frank specifies that nonvoting members of FSOC, such as State banking regulators, must not be excluded from FSOC activities.

So I think it is important that we have our stakeholders in the States involved, and do you know why the State regulators have been excluded from the working group?

Secretary MNUCHIN. I don't, but it is not intentionally. I don't remember kind of whether they were excluded from the FSOC. I would say right now it is not an important issue, but if the State regulators want to be part of it, we will absolutely accommodate them.

Mr. LOUDERMILK. Okay, I would appreciate it, again if you could keep us abreast of that.

And I want to close out by thanking you for your part in this robust historic economy that we have. I see that we could even add another $68 billion into this robust economy if we could move forward with the USMCA, and I hope that very soon we can put the American people first and move forward with that.

With that, I yield back, Mr. Chairman.

Mr. PERLMUTTER. The gentleman yields back. The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Mr. Secretary, thank you so much for coming before our committee again.

As you know, my district is the third-poorest congressional district in the country, and the economic recession devastated my district. We are still recovering not only in Detroit, but even the Wayne County communities throughout my district.

And one of the things that we did through Dodd-Frank, as you know, is create the Financial Stability Oversight Council. That kind of oversight of shadow banks is going to be critical, too-big-to-fail kind of banks and so forth.

Under your tenure so far—and again, I would love to hear your vision of what you think this Council is supposed to do because so far under your tenure, Mr. Secretary, we dropped the appeal of the district court's decision in the MetLife lawsuit. I think there is not one single non-banking institution that is designated as too-big-to-fail, or what I believe we call, systemically important financial institutions (SIFIs).

What is the direction that we are going in, if we are not doing any oversight? The whole purpose of Dodd-Frank was so that we don't have another downturn, an economic recession that led to predatory practices by these big banks.

Secretary MNUCHIN. First, let me say, I share your concern and your issues, and we are doing a lot on oversight. The committee is very focused—

Ms. TLAIB. But you don't have anybody to regulate.

Secretary MNUCHIN. Again, the fact that companies haven't been designated—

Ms. TLAIB. Not one single institution, correct?

Secretary MNUCHIN. Again, that is a good thing. That is because the companies deleveraged significantly.

Ms. TLAIB. So you think MetLife, Prudential—none of those are too big-to-fail?

Secretary MNUCHIN. That is correct. As a matter of fact, they are a lot better capitalized, and by the way, GE Capital was de-designated prior to us coming here. So, part of the benefit of the designation was it encouraged all these companies to de-risk so they wouldn't be designated, and they wouldn't be regulated by the Fed, so that they have proper regulators.

I want to be clear: The committee's job is to bring all the regulators together to make sure that the primary regulators are regulating these entities.

Ms. TLAIB. But by dismissing the case, I believe, in the MetLife lawsuit, we don't have that much authority now that we have walked away by saying that they would fall under certain guidelines for oversight.

Secretary MNUCHIN. Actually, that is not the case at all. We have the same authority as we always had. The only issue we have talked about is including a cost-benefit analysis, which we think was required by law.

I just want to be clear: I view it as good news to the economy that we don't have anything designated. And if we were sitting here with lots of entities designated, that would be a major concern of ours.

Ms. TLAIB. Mr. Chairman, if I may, I would like to submit for the record, "Strengthening the Regulation and Oversight of Shadow Banks."

Mr. PERLMUTTER. Without objection, it is so ordered.

Ms. TLAIB. Last question, and it might be out of whack, but this is important for me to understand. Do you believe in socialism for corporations?

Secretary MNUCHIN. Do I believe in socialism—

Ms. TLAIB. Socialism for corporations.

Secretary MNUCHIN. —for corporations? No, I—

Ms. TLAIB. A lot of people talk about socialism. I want to know, do you believe in it?

Secretary MNUCHIN. I do not believe in socialism for corporations.

Ms. TLAIB. Thank you very much. I yield back.

Mr. PERLMUTTER. The gentlewoman yields back. The gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman, and thank you, Mr. Secretary, for being here.

As you may know, I have been working with your staff on some World Bank reform issues, and I just want to thank you for your collaboration on that. To me, I think, when I look at the World Bank, the number-one issue is ensuring that China graduates from the loan program. It is unconscionable to me that my taxpayers, our taxpayers should, in any way, shape, or form, be subsidizing the Chinese growth model.

And my understanding is that today, at this very moment, or maybe it has already happened, China's country partnership framework is going to get a vote at the bank. I couldn't access the document. That is not your fault. It wasn't on the bank's website. But my understanding is that it provides loans for $1 billion in perpetuity and assistance in advancing the Chinese growth model internationally, a growth model that has social credit scores, interns its own people, and obviously, what is going on in Hong Kong. It's a huge issue for me.

I guess my first question is, just at a basic level, do you agree with the graduation objective? Do you believe that China should be made to graduate at the World Bank?

Secretary MNUCHIN. I do.

Mr. GONZALEZ OF OHIO. And then, second, as a follow-up, what is the best way to ensure that occurs? Because right now, it feels like we have our hands tied behind our back. Despite the fact that we are the largest shareholder and have veto authority, it still feels like we have no ability to affect this. So, how can we do it?

Secretary MNUCHIN. I don't think that is the case. I think that, again, as I mentioned earlier, this is something that David Malpass worked on with the World Bank when he worked for me. This was his number-one issue in reforms. Now at the World Bank, and leading the World Bank, he has worked with China.

China actually, I understand, is cash flow-positive this year, meaning there is more cash coming into the World Bank than cash going out. I believe they are going to be under $1 billion this year, and he is working towards them—and by the way, in the China program, as I have said, our executive board member has objected to the program, and I think that gets read in, and ultimately, that will be on the World Bank's website.

Mr. GONZALEZ OF OHIO. Yes, and I guess he objected, but we do technically have veto power, right? Can you explain how that would work so that—

Secretary MNUCHIN. Just to be clear, we don't have veto power over every single loan or veto power over a specific statement. We have veto power over capital allocations and other issues. But again, I have great confidence in David Malpass. He understands this issue. He is working with China on this issue. We all share the same objectives.

Mr. GONZALEZ OF OHIO. Yes. And I appreciate it. I certainly appreciate the progress, right? But for me, even a dollar is too much for our taxpayers to be contributing to China.

As you may know, I have also recently introduced legislation to support the policy that you just articulated to transition China off of bank lending. I appreciate your staff's feedback and I look forward to further collaboration.

Another section of my bill deals with debt transparency with respect to the Belt and Road Initiative. I see providing debt management assistance as a vital piece of our national strategy, with some of our partners and allies sharing the same concerns regarding China's lending practices.

Can you talk about the current strategy and efforts to provide debt management assistance at the World Bank and the International Monetary Fund (IMF) to borrowing countries of the Belt and Road Initiative? And what are we doing to get other partners and allies fully onboard?

Secretary MNUCHIN. We have a lot of support on this issue both from the leadership of the World Bank and the leadership of the IMF, as well as the G-7. Everybody supports debt transparency. It is very important that China play by these common rules, and we have had very direct discussions with them.

Mr. GONZALEZ OF OHIO. Thank you.

Secretary MNUCHIN. And as conditions of certain IMF programs, without me going into specifics, we have demanded complete transparency on exposure.

Mr. GONZALEZ OF OHIO. Thank you, and I look forward to continuing to work with your staff on these issues. I think they are critically important.

Shifting a bit to the Volcker Rule, I sent you and the prudential regulators a letter this week about the importance of establishing a regulatory framework that promotes investment opportunities in startups and small businesses. I know the Volcker regulations are considering revisions to the covered funds portion of the Volcker Rule.

For me, prior to this job, I ran a Silicon Valley tech startup. It is very easy to acquire capital in that industry, in that section of the country, and less so where I am from in Northeast Ohio, and whom I represent.

Can you talk about your thoughts on this specific issue and how it would impact private capital flowing into communities outside of places like Silicon Valley?

Secretary MNUCHIN. I commented on this earlier, but we are working on the regulators, and I hope over the next 3 to 6 months we can address this. I do think it is something important and will help small businesses. In no way is it going to impact systemic risk.

Mr. GONZALEZ OF OHIO. Thank you, and thank you for your leadership. I yield back.

Mr. PERLMUTTER. The gentleman yields back. The gentleman from Illinois, Mr. Casten, is recognized for 5 minutes.

Mr. CASTEN. Thank you, Mr. Chairman. And thank you, Secretary Mnuchin, for being here today. I introduced H.R. 5194, the Climate Change Financial Risk Act, with Senator Schatz, of course, introducing the companion bill in the Senate, to create a climate change risk subcommittee within FSOC and to report annually on systemic risks of climate change to the financial system. The reasons for that are, and I am sure you know this, but just to reiterate for everyone here, from 2016 to 2018, average economic losses from natural disasters were $150 billion. I just returned from Madrid. The goal of the Paris Agreement is to stay under 1½ degrees of additional warming. We are not globally on that target right now. We are not even at 2 degrees. Right now, if we don't change direction, we are at 4 degrees of warming. Eight degrees of warming is within the zone of possibility. At 8 degrees, Manhattan feels like Qatar, essentially. It is really unpleasant. At 4 degrees of warming, the global losses could hit $23 trillion per year.

There are already predicted to be 311,000 homes that will be regularly inundated by 2045, and millions by the end of the century. This dwarfs the financial crisis, and presumably a lot of those homes will be subject to 30-year mortgages. So by any analysis, that is systemically disastrous, and I want to just follow up. You expressed doubt earlier in this hearing about whether bank stress testing was necessary to assess the impacts of the climate crisis. Have you consulted with any climate scientists in the course of coming to that conclusion?

Secretary MNUCHIN. So, again, let me just preface, I have expertise on a lot of issues, but climate is not one of them.

Mr. CASTEN. No, no. That is why I am asking whom you consulted with.

Secretary MNUCHIN. I think there is a place and a role to study the climate issues and the impact on the economy. I don't think FSOC is that place, and I think there are plenty of other areas.

Mr. CASTEN. Does the Office of Critical Infrastructure believe that there is no systemic risk from the climate crisis, because you are not an expert in cyberterrorism either, but presumably we do look at those—

Secretary MNUCHIN. Actually, I have become an expert in cyberterrorism. I spent a lot of time on that because that is my primary responsibility.

Mr. CASTEN. I don't mean to criticize your expertise, but I am saying there are systemic risks that the Office of Critical Infrastructure has concluded. So, have they concluded that climate change is not a systemic risk?

Secretary MNUCHIN. I don't believe they have concluded that it is a systemic risk. I don't know in the negative if they have concluded it the other way, but let me just comment, outside of the United States, there are some areas where climate issues are very, very, very significant. So, I think the U.S. has made a lot of progress on this.

Mr. CASTEN. No, we haven't. We are not on a sustainable path, but let me just throw out some numbers. Likely sea level rise, we already know if we went to zero CO2 tomorrow, we still have another 2 feet baked in. Realistically, we probably have meters measured in. So at the likely sea level rises of the best analyses, there are $900 billion worth of U.S. homes that are underwater by the end of the century. That is at current values. They would be worth a lot less by the time they go underwater. Has FSOC analyzed how that would impact the financial system?

Secretary MNUCHIN. Not to my understanding, it hasn't.

Mr. CASTEN. Okay. The projected private investor losses globally, depending on the warming scenario, somewhere between $4.2 and

$13.8 trillion, depending on the scenario. Has FSOC estimated the effect on systemic financial stability from those losses?

Secretary MNUCHIN. Again, as I have commented earlier, and you have obviously spent a lot of time on this and I appreciate that, there is a place and role to analyze these. I think that the issue for FSOC is to make sure that banks have proper disclosure, but I don't believe this is a systemic risk that warrants FSOC review, but I will discuss it with the committee. You have brought it up. I am happy to discuss it with the committee.

Mr. CASTEN. Okay. The concern, and just as I think about these things, obviously none of us are rooting for this. But if I am an insurer and I am looking at these risks out in the future at some point, not right now when I only have a 1-year policy in front of me. But when we start to get to the point where those policies are coming due, I am going to start changing my risk profiles. I am going to stop insuring certain sectors. We have seen what the maps of the country look like, and where you will not want to live, and where we are going to have crop failures, and it is impossible for me to see a scenario where those don't become systemic risks.

Just before I left for Paris, I watched "Planes, Trains, and Automobiles" with my daughters, and I am reminded of that scene where they are driving down the road the wrong way and everybody says, you are going the wrong way. They don't even know where we are going. We are going the wrong way. We know we are in the wrong lane. We know there are a couple of trucks coming down the highway at us. And if you don't think that FSOC should do it, I guess I respectfully disagree, and that is why we introduced the bill, because I think we need to look into these risks so that we can swerve while we still have time. Thank you. I yield back.

Mr. PERLMUTTER. The gentleman's time has expired. The gentleman from Tennessee, Mr. Rose, is recognized for 5 minutes.

Mr. ROSE. Thank you. Welcome, Secretary Mnuchin. It is good to have you here today, and thank you for taking time to visit with us. One of the defining tenets of our insurance industry is that it, is by and large, State-regulated. It is the strength of the country, and it is something we need to defend. Secretary Mnuchin, like so many of my colleagues here today, I want to thank you for your efforts to defend our State-based insurance regulatory regime, for your close and collaborative work with the State insurance commissioners, and for registering Treasury's official opposition to the International Capital Standard (ICS) in Abu Dhabi.

I know there is still work to do on behalf of Team USA to ensure foreign bureaucrats don't dictate the rules for U.S. insurance regulations, so I appreciate your continued efforts on the ICS and hope you will continue to engage with Members of Congress and the State insurance commissioners as we move forward. Secretary Mnuchin, since the ICS was adopted, what are some of your main concerns with the current framework?

Secretary MNUCHIN. Let me say I am pleased to hear that there is bipartisan support on this issue. We do very much support the State regulatory mechanism for insurers, and we are concerned, and we have expressed these concerns, that although they are not required to be adopted, that it could force the industry in a way that is detrimental to our leadership and our State-based regulators.

Mr. ROSE. Thank you. Vice Chair Quarles said in his January 2019 remarks at the American Council of Life Insurers that the Federal Reserve's building block approach, or BBA, could strike a better balance between entity-level and enterprise-wide supervision of insurance firms, which would facilitate the continued robustness of product availability here in the United States. I believe part of the intent behind developing the BBA was that it could be deemed comparable to the ICS. Mr. Secretary, are you familiar with the BBA?

Secretary MNUCHIN. I am not completely, but I will follow up with your office. We have a lot of people who are experts, as you know, and have spent time on this, and focused on it for me.

Mr. ROSE. Okay. Thank you. Do you think, based on what you know now, that the BBA framework could eventually be recognized as an outcome equivalent approach to the ICS, and would it be preferable, in your opinion?

Secretary MNUCHIN. Again, I want to get back to you on that, but I believe that is the case. But I want to get back to you on that issue.

Mr. ROSE. To reiterate, I believe it is important that we, as Members of Congress, also continue to voice our bipartisan support for the State-based insurance system. And so, along those lines, I want to thank my colleagues, Mr. Heck and Mr. Budd, for introducing the International Insurance Standards Act again this Congress, which I was proud to co-sponsor. Mr. Secretary, is there anything else that you are aware of that we, as Members of Congress, should be doing to help the USA's position on the ICS?

Secretary MNUCHIN. I think not, at the moment. You have been very supportive working with our office, and we have had a lot of bipartisan support as we work with Team USA to represent these issues.

Mr. ROSE. Thank you. Transitioning over to some other issues, I wanted to ask you about the FSOC's work on the transition away from LIBOR as a reference rate. LIBOR is set to be phased out as a bank reference rate by 2021. From the FSOC's September minutes, I understand LIBOR is the underlying reference rate for approximately $200 trillion in financial contracts worldwide. Secretary Mnuchin, I know this will likely cause a bit of disruption in our markets and that the Alternative Reference Rate Committee's preferred alternative to LIBOR is the Secured Overnight Financing Rate, or SOFR. What makes the SOFR a suitable alternative?

Secretary MNUCHIN. I think the most important issue is that we have a transition from all these loans and all these securities. The thing that we like about SOFR, and, again, this work predated me, is that it is a very liquid market. It can't be manipulated, and it is readily calculable. I met with a group of banks yesterday. There may also be, no different than there were LIBOR loans and there were prime loans, there may be more of a credit-oriented index that develops as well. But we are very focused on the transition.

Mr. ROSE. And in the remaining seconds here, as we transition from LIBOR to SOFR, what sort of outreach is Treasury doing to engage with stakeholders as attention to the LIBOR transition increases?

Secretary MNUCHIN. We have a huge group working on it. As I mentioned yesterday, myself, Chairman Powell, and a bunch of the regulators met with 10 of the CEOs, and we continue to have outreach working on this.

Mr. ROSE. Thank you, and I yield back.

Mr. PERLMUTTER. The gentleman yields back. The gentlewoman from Virginia, Ms. Wexton, is recognized for 5 minutes.

Ms. WEXTON. Thank you, Mr. Chairman, and thank you, Secretary Mnuchin. It is nice to have you back with us today. In September, the House passed the Uyghur Human Rights Policy Act, which is bipartisan legislation that was authored by Senator Rubio and co-sponsored by 44 Senators and 130 U.S. Representatives, including many on this committee. This week, the House passed the Uyghur Intervention and Global Humanitarian Unified Response Act, or the Uygur Act. Both of these bills seek to hold officials in the Chinese government and the communist party responsible for the gross violations of human rights in China's Xinjiang Uyghur autonomous region, including the mass internment of over 1 million Uyghurs, as well as China's intimidation of U.S. citizens on American soil. The Uyghur Act passed 407–1. Would you recommend to President Trump that he sign these bills when they come across his desk?

Secretary MNUCHIN. I am not going to make any comments publicly about what my recommendation will be to the President one way or another, but that doesn't mean I am not recommending it.

Ms. WEXTON. Okay, because we are getting mixed signals from the White House officials, and reporting is suggesting that the Treasury Department, and you in particular, are responsible for blocking or slow-walking efforts to hold Chinese officials accountable.

Secretary MNUCHIN. No, that is not accurate.

Ms. WEXTON. Okay. Well, I am going to read from an article, an October 8, 2019, New York Times article, which I would like to submit for the record, Mr. Chairman.

Mr. PERLMUTTER. Without objection, it is so ordered.

Ms. WEXTON. "Senior officials in the National Security Council and in the State Department have pushed for the use of the entity list to target Chinese companies supplying surveillance technology to the security forces in Xinjiang. They have also urged Mr. Trump to approve sanctions that would penalize Chinese officials and companies involved in the abuses. The top American trade negotiators, including Treasury Secretary Steven Mnuchin, have cautioned against policies that would have upset trade talks."

Are you saying that is inaccurate reporting?

Secretary MNUCHIN. That is inaccurate reporting, and I think you know how we feel about the New York Times.

[laughter]

Ms. WEXTON. But are you willing to sacrifice human rights abuses for the sake of trade talks, because it certainly appears that way?

Secretary MNUCHIN. Again, let me just say I am here to talk about financial stability, but I will respond to your question. I very much am concerned about human rights issues all over the world. We administer Global Magnitsky sanctions all over the world on sanctions. We administer things in China as in other places, but I am not going to make any comments on confidential discussions I have with the President on these or other subjects.

Ms. WEXTON. Related to that, back in April, I joined a number of other Members of Congress and the Senate in a letter addressed to you, Secretary Pompeo, and Secretary Ross urging the Administration to employ Global Magnitsky sanctions on senior policy leaders who were complicit in these gross violations and human rights abuses, including Chen Quanguo, who is the so-called architect of the roundup of Uyghurs, and we never received a response from Treasury or from you. So while I have you here, what is the status of Global Magnitsky sanctions on Chen Quanguo and other senior party leaders in China?

Secretary MNUCHIN. I thought State had responded for that letter on behalf of all of us. We will get back to you.

I thought State responded from all of us, but as a general comment, we don't make comments on future sanctions at all, although I will tell you, whenever we get letters, we take these things seriously.

Ms. WEXTON. And that letter was sent in April, more than 6 months ago. We have gotten no response, and there has been no action by Treasury.

Secretary MNUCHIN. Again, if the letter was written to all three of us, it is common that one agency responds if it is an interagency issue. It is not common that we all respond. Again, did the State Department respond to you?

Ms. WEXTON. Yes, but they did not respond on Treasury's behalf—

Secretary MNUCHIN. Again, the way we work on interagency issues is the primary agency that is responsible for an issue responds. And, again, I won't comment on future sanctions other than to say that article is inaccurate.

Ms. WEXTON. And while we are discussing human rights violations, I want to follow up on a question I asked you last time you were here, about 6 months ago. When is the Administration going to hold Mohammad bin Salman accountable for ordering the brutal murder of journalist, Jamal Khashoggi?

Secretary MNUCHIN. Again, I don't see what that has to do with financial stability, and you are also making certain assumptions. But I can tell you, because I was the official who went over after Secretary Pompeo, and, again, we had very direct discussions about our concerns on these issues.

Mr. PERLMUTTER. The gentlelady's time has expired. The gentleman from Indiana, Mr. Hollingsworth, is recognized for 5 minutes.

Mr. HOLLINGSWORTH. Good afternoon. I really appreciate you being here and I appreciate your continued efforts at the Treasury Department to ensure that we get to those better outcomes we have always talked about for the American people, for the American economy, and for American competitiveness around the world. And I know from many of our dialogues and discussions, your passion for that very same topic.

I did want to ask a little bit about some of the public debt market structure. I know you have had a lot of conversations about this. You have spoken publicly about it. But I wanted to better understand kind of where Treasury is with regard to disseminating data in the Treasury market. This is something that for every other asset class, for most other assets that are traded, you get both price and volume information after the fact, which has led to increased competitiveness, increased liquidity, and also lower transaction costs associated with that market. And I know Treasury has been looking into that for quite a while, and I think recently said that they were going to start disseminating, much after the fact, volume data, but were going to put out pricing data or volume data that were very close to those trades. I was curious why that decision was made when FINRA keeps all of that data? And are there further steps that are going to be taken to release more data around transactions in the Treasury market? That was a long-winded question, sorry.

Secretary MNUCHIN. No, no. Let me respond.

Mr. HOLLINGSWORTH. Yes, please.

Secretary MNUCHIN. Look, this is a complicated issue, okay?

Mr. HOLLINGSWORTH. Right.

Secretary MNUCHIN. First, let me just say, the U.S. Treasury market is one of the most liquid markets in the world. It has very small transaction costs, and obviously it facilitates our borrowing. So, our number one objective is to make sure that we not do anything that is detrimental to—

Mr. HOLLINGSWORTH. I totally understand that, and I stipulate to you that it is a well-functioning market.

Secretary MNUCHIN. We have studied this carefully, and trying to balance the disclosure issues and whether that really is going to help or hurt the market. I will say, as you look at some of these other markets, and you look at the data, there is less liquidity in a lot of these other markets. Now, part of the reason why there is less liquidity, I will acknowledge, also has to do with the Volcker Rule to proprietary trade. When you look at transaction costs, you have to look at transaction costs in the context of overall liquidity. And we are happy to come and talk to you about it, but we want to make sure we get this right. And if it were clear to us that releasing all the data would create more liquidity and more transparency, we would be doing it.

Mr. HOLLINGSWORTH. I certainly understand the do-no-harm philosophy, and I really appreciate that. And I stipulate to you, as you articulated very well, that it seems to be a well-functioning market. There have been some blips along the way, October 2014 notably, right? It is hard for me to imagine, and I hope you might expound upon, the potential harm from transparency in price and volume data. I understand that you want to do no harm, but it is also hard for me to understand what that harm might be. Could you help me understand a little bit about that?

Secretary MNUCHIN. Again, I think there are times when we have gone back and looked at the data as it relates to other markets, okay?

Mr. HOLLINGSWORTH. Yes.

Secretary MNUCHIN. There are times when releasing the data hurts liquidity. I would also say another interrelated issue is the advent of electronic trading, and a larger and larger portion of the government market is from people who invest virtually no capital, but take advantage of sophisticated algorithms.

Mr. HOLLINGSWORTH. Right.

Secretary MNUCHIN. So, again, I want to make sure that the release of data actually is helping the market and not just creating arbitrage opportunities for people who want to do electronic day trading.

Mr. HOLLINGSWORTH. I totally agree. I don't want to be pejorative to those who are taking advantage of those small arbitrage opportunities because they are helping to close the market, right in a real and meaningful way. And I don't want us to make a decision because we want to prevent somebody from being able to take advantage of that and not providing the transparency that the market may benefit from.

And I agree it is well-functioning today. It is well-functioning on many, many days. But I want to ensure that transparency is an important part of that market going forward, as do you, and I am certain that we share that passion. It is just sometimes hard for me to understand what harm might come on account of that. And I understand that you have looked at other markets and have seen some adverse impact of liquidity, but, as you well know, it is really hard to hold everything constant when you are looking at different time periods, different markets, different asset classes. And so, I respect the fact that you have a lot smarter people than me over at Treasury to look into that. I will follow up with a question for the record.

But I wanted to transition really quickly and talk about the Taxpayer First Act that was signed into law in July. It included a provision that persons receiving return information must obtain the express permission of taxpayers. My question is really going to come down to, the law stipulates that it is to become effective on December 28, 2019. I think there has been some guidance from the IRS that that is for all transcripts for everything that is sold after December 28th by Fannie Mae and Freddie Mac, and it may apply to those things that are before December 28th. And I want to get some clarity around that as quickly as possible because it is important to the functioning of the—

Mr. PERLMUTTER. The gentleman's time has expired.

Mr. HOLLINGSWORTH. Thank you. I yield back.

Mr. PERLMUTTER. The gentleman yields back. The gentlewoman from Iowa, Mrs. Axne, is recognized for 5 minutes.

Mrs. AXNE. Thank you, Mr. Chairman, and thank you, Secretary Mnuchin, for being here again today. I know that we have heard a lot of criticism about the 2017 tax cuts as primarily benefiting the richest Americans. I absolutely think that is accurate, but that is not what I want to focus on. What I am interested in looking at is how the IRS is treating the wealthy. The Wall Street Journal reported that IRS audit rates for people making more than $10 million a year have dropped more than 80 percent in just the last 4 years. Why are the top 1 percent's tax returns being looked at so much less frequently?

Secretary MNUCHIN. That is actually not the case, and I am working with the IRS to release the data, because one of the issues is the way the IRS releases the data now is on closed cases, not open cases. But I can assure you, when I saw that article, I had the same concern, and I called up the Commissioner, and I said we should be doing more of these audits, not less. So, we are going to release this data in a transparent way to assure you that the people who are making the most money are getting high audit rates.

Mrs. AXNE. Well, that is fantastic to hear.

Secretary MNUCHIN. By the way, if you want to give us more money for enforcement, I am happy to take it.

Mrs. AXNE. We will absolutely talk with you about that. I think that is a great idea. So are you telling me then the number is much lower that is being audited?

Secretary MNUCHIN. No, it is higher, as a matter of fact, thank you. So, again, this is the problem in the data you guys just gave me. The way we report the data is on closed audits, and these audits take obviously a long period of time. I am happy to come back, and I am going to get the IRS to release it publicly. The way I think we should be looking at the data is for each tax year, what percentage of an income group are we auditing, not what percentage has closed in that year.

Mrs. AXNE. Okay. That would be great. If you could get that over to this committee, or to my office, I would really appreciate that, as well as if you could make sure that it tells us what percent is currently being audited.

Secretary MNUCHIN. What people should want to understand is not what percentage of the audits were closed in the year. What people should want to understand is in a tax year, what percentage of those people will be audited, whether it was closed in 2018, 2019, 2020—

Mrs. AXNE. Sure.

Secretary MNUCHIN. We will get you the data.

Mrs. AXNE. No, that—

Secretary MNUCHIN. I can assure you I had the same view when I saw it.

Mrs. AXNE. Listen, I am glad to hear that. My concern is I just want to make sure that those who are the wealthiest among us in this country are being audited at the same rate that other folks are, and from what we can see right now, which is the data that we are able to have access to, it shows that they are being audited at a much lower rate. So if you can provide us with information that differs from that, I would love to see that. So, I appreciate that.

The next thing I want to talk about is back to the 2017 tax law. It included two provisions intended to limit the use of tax havens for multinational corporations, of course, Global Intangible Low-Taxed Income (GILTI) and Base Erosion and Anti-abuse (BEAT). The IRS's own data shows that in 2016, U.S. corporations booked more than $33 billion of profits in Bermuda, despite having only 384 employees there. So for anyone trying to do that math, this is high productivity. That is more than $85 million per employee. My goodness. Now, I know that data is from 2016. That is before the tax cuts were passed, but I am using it because it is the last information that we have. So, Mr. Secretary, my question is, has there been a significant reduction in profits booked in Bermuda in 2017 or 2018 data?

Secretary MNUCHIN. I don't have that data. We are happy to look into it and get back to you.

But I will tell you, part of the reason we moved from a global tax system to a territorial system with the GILTI tax was to basically prevent people from moving to tax havens, and to make sure that the U.S. taxed companies fairly.

Mrs. AXNE. Okay. Great. I am so glad to hear that because from what we are seeing right now, and what we have seen in the past, that is not happening. I would love to see if we are making some improvement on that. Obviously, I want to make sure that we limit corporations' use of tax havens. We need all that money here in the United States so we can address things like infrastructure and things that people in this country need. I guess I would ask you, what suggestions do you have for continuing to work on curbing the use of tax havens?

Secretary MNUCHIN. Again, there were many regulations we put out through the last 2 years on the Tax Act that limit these types of things. And, again, we are happy to follow up with you specifically on some of them.

Mrs. AXNE. Okay. And then lastly, the European Union has actually had success in reducing tax havens simply by requiring public disclosure of country-by-country income. Is that something you think might help?

Secretary MNUCHIN. Not necessarily, although I will say, a lot of the information exchange with the Europeans is helpful in looking at tax havens.

Mrs. AXNE. Thank you.

Mr. PERLMUTTER. The gentlewoman yields back. The gentlewoman from New York, Ms. Ocasio-Cortez, is recognized for 5 minutes.

Ms. OCASIO-CORTEZ. Thank you, Mr. Chairman, and thank you, Mr. Secretary, for coming in today. I looked through the minutes of the FSOC meetings this year, and I didn't see any mention of student loans. The total outstanding student loan debt burden is now at over $1.5 trillion. Young people are waiting until their 30s and 40s to have children, buy a home, and make other major purchases. Do you believe that student loan debt currently poses a major risk to our financial stability?

Secretary MNUCHIN. I share your concern on student loans, although I don't think it is a major risk to financial stability. But I can assure you on an interagency basis, we are working with the Department of Education and the NEC, because I think in many cases, people have taken out student loans that have created certain issues for them. So, student loans are a large part of the debt, and that is something we are carefully studying.

Ms. OCASIO-CORTEZ. So it is a problem, but not a major risk to financial stability? I just wanted to kind of run through a few different topics here. Turning back to the minutes from the FSOC meetings, I also didn't see any mention of climate change. Do you believe climate change poses a risk to our economy?

Secretary MNUCHIN. You may have missed my comments before on this—

Ms. OCASIO-CORTEZ. Oh, my apologies.

Secretary MNUCHIN. I acknowledge that climate change should be discussed in certain areas. But FSOC is not an area where I believe it should be discussed. But based on previous discussions, I said I would raise that with the committee.

Ms. OCASIO-CORTEZ. Okay. Let's talk about leveraged lending. I know there was some discussion of it earlier, but it is up 20 percent this year with a total outstanding balance of over $1 trillion for the first time. I heard earlier you don't think it poses a threat to our financial system either, is that correct?

Secretary MNUCHIN. Not at this time, and, specifically, it doesn't pose a threat to the banking system or the insurance system. But this is an area that FSOC will continue to monitor on a quarterly basis because it is an area, particularly if the economy slows down, that we want to carefully monitor.

Ms. OCASIO-CORTEZ. Do you see similarities between collateralized loan obligations and mortgage-backed securities that helped trigger the 2008 financial crisis?

Secretary MNUCHIN. Not at all.

Ms. OCASIO-CORTEZ. No. We have talked about student debt. What about medical debt? We spent about $3.3 trillion on healthcare last year. That is more than $10,000 per person. That is up almost 20 percent over the last 5 years. Do you believe that medical debt poses significant risks to our financial system?

Secretary MNUCHIN. Again, I would say this is not an FSOC issue, but putting on my Treasury hat, we are concerned about the rate of growth of medical expenses. And that is something where we are trying to look at many different things, because that does pose economic issues, although not financial stability issues.

Ms. OCASIO-CORTEZ. Okay. What about housing? I see some mention in recent FSOC minutes about mortgage origination from non-bank lenders. So I am assuming you at least agree that there are some problems in the housing market that can pose threats to the stability of the financial system in that respect?

Secretary MNUCHIN. Yes, I commented earlier that we are monitoring the amount of the mortgage market that has moved out of the banking system. Particularly, we are focused on non-bank servicers that don't have liquidity, and we hope to work with this committee and others on housing reform. It is an important issue.

Ms. OCASIO-CORTEZ. What percentage of mortgages were originated by non-banks this year?

Secretary MNUCHIN. I think it is roughly 50 percent.

Ms. OCASIO CORTEZ. Fifty percent. So half of mortgages in America are being originated by non-banks. That puts them outside of the usual scope of regulation. Is that correct?

Secretary MNUCHIN. No, not outside the usual scope of regulation at all. It is outside of the banks, so it is something that we are looking at carefully. And, again, a lot of those loans are sold to Fannie Mae and Freddie Mac or insured by FHA, so we are also looking at it through all those different regulators.

Ms. OCASIO-CORTEZ. And what about the overall shortage in the housing stock? The number of homes for sale is about 6 percent nationwide, and it is down more than 15 percent in several large metropolitan areas. Does the fact that this market seems to be slowing down pose a risk to the financial system?

Secretary MNUCHIN. Again, not risk to the financial system, but affordable housing is something we are concerned about and making sure that there is greater access to affordable housing. It's not an FSOC issue, but a Treasury issue.

Ms. OCASIO CORTEZ. Okay. So we have here student loan debt does not pose a risk to financial stability. Climate change, potentially. Leveraged lending does not. Medical debt does not. Mortgage origination does not. What are some of the largest risks to our economy right now?

Secretary MNUCHIN. Again, there is a larger—

Ms. OCASIO-CORTEZ. And the financial system.

Secretary MNUCHIN. The financial system. I don't know if you had a chance to read the report. But, again, if you just look at, and we highlight cybersecurity, structural issues, alternative reference rates, risk to the credit expansion. We specifically talk about nonbank mortgage origination, financial innovation, housing finance.

Ms. OCASIO-CORTEZ. And do you see that there is kind of a decoupling here with the quality of life from what we are seeing in terms of measurements of financial stability?

Secretary MNUCHIN. No, I am not making that connection, but I am happy to explore that.

Ms. OCASIO-CORTEZ. Okay. Thank you very much.

Chairwoman WATERS. The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman, and, Mr. Secretary, you are almost at the end of the line here. I was compelled to come back and take my 5 minutes. I wasn't originally, but I had to ask you to elaborate a little bit more on your dialogue with my friend, Mr. Heck from Washington, on capital expenditures and tax cuts. My views on this, having spoken to many manufacturers and agricultural businesses in Central and Eastern Kentucky, is that there is no doubt that the expensing provisions and bonus depreciation accelerated business investment, and improved productivity. In fact, most of the CEOs and small business owners said that tax cuts were huge in terms of pulling forward investment that they needed to enhance the productivity of their businesses. Large and small businesses told me that, and it has made their employees more productive.

And so my theory is, when you look at Mr. Heck's chart of declining capital expenditure (CAPEX), it certainly wasn't caused by tax cuts. Tax cuts may have pulled forward a lot of capital expenditures and business investment, but what most private sector people tell me is that the decline in capital expenditures is not attributable to anything other than trade uncertainty. And also they note, many of them would continue to invest in capital, and equipment purchases, and other items that would make their businesses more efficient and more productive if the Democrats would stop opposing making those provisions permanent in the Tax Code. The uncertainty of not having permanency with the bonus depreciation and expensing provisions is maybe an impediment for continued CAPEX.

I want your thoughts on that feedback that I am getting from actors in the private sector on CAPEX. I also want your opinion about how trade uncertainty is contributing to a pause in additional business investment.

Secretary MNUCHIN. First of all, thank you for coming back. There is no question from the companies that we are visiting all over the country that there have been major capital expenditures as a result of the Tax Cut Act. And as you said, this incentivized companies because they get automatic expensing, which I would just comment on, when people ask about, will the tax cuts pay for themselves, I remind them this has to be calculated over a 10-year period of time because this was designed to stimulate investment and lead to expensing in year 1, which will recoup in year 5, 6, 7, 8, 9, and 10. As it relates to trade, I would say there are a lot of people who are waiting on the sidelines because of USMCA.

Mr. BARR. Right.

Secretary MNUCHIN. I am hopeful that Congress will pass USMCA between now and the end of the year. It is the single most important economic trading relationship we have. And there is no question that passing it will add something like 50 basis points to GDP, and it will increase capital expenditures.

Mr. BARR. I agree, and reclaiming my time, USMCA is why we don't have that line continuing to go up in terms of capital expenditures, so the best thing we can do in a bipartisan way in this Congress is to pass the USMCA. And I would argue that that is going to give you and Ambassador Lighthizer momentum with China and the EU if we can lock in USMCA. So I encourage my colleagues on the other side of the aisle to join us in supporting this renegotiated North American trade deal for all those reasons.

In my remaining time, I want to talk to you about leveraged lending. There has been lots of hand-wringing on the other side, in particular, about the growth in corporate debt. And I wanted to ask you your views on collateralized loan obligations (CLOs), in particular, as non-bank investor vehicles, taking some of this leverage out of banks, federally-insured depository institutions, into these CLO vehicles, and the extent to which CLOs non-market long-term vehicles provide liquidity, and could provide liquidity precisely in the time where we need it, in an economic downturn, and to that extent, offer the financial system a tool, a financial stability tool; and that if we overreacted to leveraged lending, particularly if we overreacted to CLOs, that could actually have a destabilizing effect and limit liquidity right when we need it.

Secretary MNUCHIN. I would agree with you, and I would even go one step further, which is that a significant problem of the financial crisis was that there were too many high-risk mortgages in the banking system. So, the good news is the higher-risk leveraged lending has moved out of the banking system into permanent capital vehicles.

Mr. BARR. Thank you. I yield back.

Chairwoman WATERS. The gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, is recognized for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman, and thank you for your appearance, Mr. Secretary. Mr. Secretary, I am on a mission of mercy. Here is why: In 2008, we had 215 minority banks; and in 2018, we had 149. Of the 149, 23 are said to be African-American banks, meaning more than 50 percent African-American ownership. And it seems, according to the Independent Community Bankers of America (ICBA)—this is dated October 22, 2019—these 23 African-American-owned banks have assets of $5 billion. Total assets, $5 billion.

I am on a mission of mercy because usually these banks are in neighborhoods wherein the people are not high-income earners. They are underserved neighborhoods. They are economically distressed neighborhoods. And they are neighborhoods in need of banks, but these banks need additional capital. So when you mentioned your Small Bank Mentorship Program, it really made my heart warm. I really would like to know how this program will help me with my mission of mercy to help capitalize these small banks that I no longer call community banks; I call them neighborhood banks. Community banks, $10 billion. These neighborhood banks, if they can get to $1 billion, there will be a great celebration. Can you please share some intelligence on the topic?

Secretary MNUCHIN. I share your concern. It is really terrible that these numbers have dropped as much as they have. And these are, as you said, some communities that really, really need these banks. The Protege Program is a step in the right direction of helping these banks, but we need to work with the regulators. We need to work with private capital in making sure that these banks have access to capital and can grow, and we turn these numbers around in the other direction.

Mr. GREEN. How far along are you with the program? My understanding is that you have a departure date that is certain in your mind. I am not sure it has been published. But will this become viable before you leave?

Secretary MNUCHIN. I wasn't planning on going anywhere anytime quickly, so, yes.

Mr. GREEN. Okay. I have heard rumors—I'm sorry—that you might be leaving.

Secretary MNUCHIN. Leaving when? I have said I would stay through the second term, so I don't—

Mr. GREEN. Through the second term? My apologies.

Secretary MNUCHIN. I don't know what rumors you have heard of me leaving.

Mr. GREEN. Listen, you are talking to a guy who is proud to apologize. I apologize. I am glad to know you will be here. So the question becomes, how can we collaborate and work together in a positive way to affect positively these African-American banks? And I am saying, "African-American," because they are at the lower end of the totem pole. No other community, no other banks, when you take the aggregate, are in this kind of dire circumstance. So I really want to work to get some help.

Secretary MNUCHIN. I will ask my staff to schedule a meeting with you. Maybe we can try do it in the beginning of January and figure out how we can work together.

Mr. GREEN. I absolutely assure you that I will look forward to this meeting. And I would just add one additional thing about these banks. I have many of them in my district, and they take pride in what they do. They have good personnel, but they don't have all of the technology that other institutions are blessed to have, and they don't have obviously the clientele, but there is a willingness to grow and to work with larger banks. This Protege Program, pairing smaller banks with larger banks, can reap some good benefits if it is done appropriately and properly. So I am eager to hear more about how we can do this pairing and to work with some of these banks, these small African-American banks. Thank you, and I yield back.

Chairwoman WATERS. Thank you. The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on National Security, International Development and Monetary Policy, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Mr. Secretary, thank you for being here, and I appreciate your response to my letter in which I discussed the whole issue surrounding the rise of white supremacy and the El Paso attack specifically, and I don't think there is much question that that that attack was motivated by white nationalism. And in my letter, I talked about the Treasury Department's ability or the tools you had available to challenge and hopefully even curb the rise of these style of acts of white terrorists, white nationalist terrorists.

In your letter, you talked about the fact that you shared my concern over the racially- and ethnically-motivated violent extremism, and then said you would use all the tools available. But you also said that you did not want to comment on any investigation, which I understand and appreciate. What I would like to know, however, is based on what the FBI Director said, which is, "A majority of the domestic terrorism cases investigated are motivated by some version of what you might call white supremacist violence, and 40 percent of the 850 domestic attacks were racially motivated."

I am one of the victims myself, as my congressional office was firebombed. But the guilty one was caught, and so I don't need any help there. But I do want to see where you are in terms of trying to help curtail financing of these criminal networks. I am not asking you about what happened in El Paso. I am asking you about in general the criminal networks that I think all of our intelligence, counterintelligence units are saying is out there. And is there something going on in Treasury where those networks are being targeted?

Secretary MNUCHIN. Let me just say I didn't realize your office had been attacked. That is just a horrible situation. Any of these attacks are just despicable. As it relates to Treasury's role, FinCEN plays a significant role in working with all of law enforcement. When I was a banker and I used to send in all those SARs, I always wondered if they went just into nowhere land, and I can tell you that these activities, and us being able to follow the money, is very important in us being able to fight all these different activities.

Mr. CLEAVER. Is there a unit in Treasury that is actually following the money?

Secretary MNUCHIN. There is. There are two units. There is both FinCEN—

Mr. CLEAVER. Yes, I am familiar with FinCEN.

Secretary MNUCHIN. —and they are the ones who take in all the data, and they have huge analytic programs that work with all of law enforcement. And the other area is obviously the RTFI area, which is less domestically and more internationally. But to the extent there are domestic issues, we work with law enforcement as well.

Mr. CLEAVER. Okay. Madam Chairwoman, thank you. I yield back.

Chairwoman WATERS. Thank you very much. I would like to thank the Secretary for his time today.

I am going to interrupt the closing. We have a hard stop at 1:00. If you will take your seat, I think we can get you out in 5 minutes. Excuse me, Mr. Secretary, for the inconvenience.

Secretary MNUCHIN. Not a problem. Not at all.

Chairwoman WATERS. But we are going to try and get this done so that we can honor your hard stop. The gentlelady from California, Ms. Porter, is recognized for 5 minutes.

Ms. PORTER. Thank you, Mr. Secretary. I really appreciate your willingness to stay, and I will be sure to be done in 4 minutes and 56 seconds. In June 2017, Treasury issued a report on banking deregulation. It suggested that if Congress raised the $50 billion threshold above which U.S. banks are subject to stricter oversight, that Congress ought to do the same for foreign mega banks. Earlier this year, the Fed followed that Treasury recommendation and massively deregulated foreign mega banks, and that was an item on a wish list that you published in 2017.

There is a lot that concerns me about this, but the most glaring for me is about Deutsche Bank. I am sure the chairwoman is very familiar with Deutsche Bank. They would now only need to submit their living will once every 6 years. This is the same Deutsche Bank that within the last 6 years had a surprise $3 billion quarterly loss—I don't know how you lose $3 billion and not see that coming—has failed its stress test in 3 of the last 4 years; was fined for a mirror trading scandal involving laundering money for Russian oligarchs; admitted to participating in LIBOR interest rate market-rigging scandals; and violated U.S. sanctions laws against Iran, Libya, Syria, and the Sudan. Why did you advocate to deregulate one of the worst corporate recidivists operating in the U.S. banking system, particularly when it is not even a U.S. bank?

Secretary MNUCHIN. Let me just first say I share many of your concerns about Deutsche Bank. I obviously can't comment on any of the specifics because from a regulatory standpoint, it would be inappropriate for me to comment specifically on Deutsche Bank. But I share many of your concerns, and particularly sanctions evasion is something that we will not tolerate by anybody, domestic or internationally. So, I am going to answer this generically, not as it relates to Deutsche Bank. The question is, will the banks be regulated? The U.S. subsidiaries, and the way that we have changed the structure, there is intermediary holding companies so that the foreign subsidiaries that are effectively U.S. institutions, we can look at the risk at that level.

Ms. PORTER. I understand the subsidiary foreign relationship. I just don't understand why we would do something that is deregulating one of the worst actors in the marketplace, and particularly when it is a foreign bank operating on our soil and threatening the stability of our markets. I understand there is a balance between regulating the industry and stifling capitalism, but if you do share my concern about Deutsche Bank, this gives us one less tool. I want to ask you about something else. How many people currently work at FSOC, the Financial Stability Oversight Council?

Secretary MNUCHIN. Again, and there have been some comments on this earlier. You weren't here, so I will just clarify. The way FSOC works is there are people who directly work under FSOC, and there are people who work at all of the different agencies.

Ms. PORTER. I am asking about the direct number.

Secretary MNUCHIN. There are hundreds of people if you add up all the different agencies and how many people—

Ms. PORTER. No, I mean people whose sole job is to work at FSOC.

Secretary MNUCHIN. There is a small group within Treasury.

Ms. PORTER. How many?

Secretary MNUCHIN. And then, there is the Office of Financial Research, which we have cut significantly because we thought those resources weren't being used appropriately.

Ms. PORTER. Because financial research isn't valuable?

Secretary MNUCHIN. Again, we didn't think that was the best use of taxpayer money, so it was really a function of, we felt that the resources within the different agencies are quite ample and quite significant that are dedicated to this.

Ms. PORTER. I just want to be clear, how many people work at FSOC and only at FSOC? Is it a secret?

Secretary MNUCHIN. Again, when you say, "at FSOC," are you referring to within the Treasury Department, who are solely dedicated—

Ms. PORTER. Let's start there. Since you are the Secretary of the Treasury, let's start there.

Secretary MNUCHIN. Again, we probably have about 10 people who are directly in the Treasury who work on that, but we probably have 50 people within Treasury—

Ms. PORTER. Does anyone work just for FSOC?

Secretary MNUCHIN. Yes, there is a small number—

Ms. PORTER. How many, sir?

Secretary MNUCHIN. Again, it is slightly less than a dozen people.

Ms. PORTER. Less than a dozen.

Secretary MNUCHIN. Yes.

Ms. PORTER. Do you know what the maximum number was at its height?

Secretary MNUCHIN. Again, comparing this to the middle of TARP, in the middle of the financial area when, by the way, there weren't resources—

Ms. PORTER. Thank you very much.

Chairwoman WATERS. Let me start over again. I would like to thank the Secretary for his time today.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witnesses and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Thank you very much. This hearing is adjourned.

Secretary MNUCHIN. Thank you very much.

[Whereupon, at 12:58 p.m., the hearing was adjourned.]

APPENDIX

December 5, 2019

Statement of Secretary Steven T. Mnuchin
Department of the Treasury
Before the Committee on Financial Services
United States House of Representatives
December 5, 2019

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for inviting me to discuss the Financial Stability Oversight Council's 2019 annual report and other priorities of the Treasury Department. The report is the product of extensive collaboration among Council members, and I appreciate the hard work by the staffs of the Treasury Department and other member agencies.

The report provides Congress and the public with the Council's analysis of financial and regulatory trends, and its assessment of potential risks to U.S. financial stability. It also provides recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets.

Since the publication of the Council's last annual report in December 2018, the U.S. economy has continued to perform extremely well. Economic growth in the United States far exceeds that of our G7 trading partners, and unemployment rates are near a 50-year low, including unemployment levels at or near all-time lows for African Americans, Hispanic Americans, Asian Americans, and women. Wages are rising faster for hardworking families; corporate and consumer delinquency and default rates are low; and financial conditions remain stable.

This year's annual report discusses a number of risks that we continue to monitor, but I want to highlight cybersecurity as one of the most important issues for the Council, regulators, and the private sector. Financial firms heavily rely on information technology, which creates great efficiencies for consumers and businesses, but also increases the risk that a serious cybersecurity incident could negatively affect the economy and potentially have implications for U.S. financial stability. We make specific recommendations in the report on this important topic. Among other things, government and industry should work together to constantly update and share best practices to ensure that we are treating cybersecurity as a vital national and economic security priority.

The report also provides a strong message to market participants about the need to prepare for the transition away from LIBOR as a reference rate. Failure to prepare adequately could cause significant disruptions across financial markets and to borrowers, given the widespread use of LIBOR in financial instruments. We recommend that market participants formulate and execute transitions plans, and that any new instruments that reference LIBOR should include fallback language to mitigate risk in the event that LIBOR becomes unavailable.

We also encourage financial regulators to evaluate the effects of new financial products and services on financial stability, including potential risks from digital assets and distributed ledger technologies. We will continue to use the Council's working group on these issues to promote consistent regulatory approaches to identify and address potential risks, while promoting America's leadership role in financial services innovation.

Turning to another of Treasury's key priorities, we will continue working with this Committee on meaningful housing finance reform to foster competition for the benefit of consumers, protect taxpayers from future bailouts, and facilitate a smooth transition for the government-sponsored enterprises out of conservatorship.

I am proud of the work we have done, with President Trump's leadership, to create a resilient, thriving, and prosperous economy. Thank you, and I look forward to answering your questions.

PUBLIC CITIZEN

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December 16, 2019

House Financial Services Committee
2129 Rayburn House Office Bldg.
Washington, DC 20515
Via email

Dear Chair Waters, Ranking Member McHenry, and Honorable Members,

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following submission relevant to the hearing titled "Promoting Financial Stability? Reviewing the Administration's Deregulatory Approach to Financial Stability."

In particular, we seek to correct the record as it relates to remarks made by Treasury Secretary Mnuchin opposing the taxing of stock, bond, and derivative trades—known as a financial transaction tax (FTT) or a Wall Street tax—in response questions posed by Rep. Wagner. Because the integrity of information is important to your policy-making, we have attached several reports here to counter statements made during the hearing. One shows that there will be negligible to no impact on average investors from implementation of a financial transaction tax, since it is a highly progressive tax. And, we included another recent report that highlights duplicitous and misleading studies that allege serious financial injury from such a tax.

We would also like to point out that not only does the FTT currently work well in other nations, reports from Europe last week show that 10 nations are on course to implement a finalized proposal to tax trades under an Enhanced Cooperation agreement, thus expanding the number of countries utilizing the tax.[1] Additionally, Sec. Mnuchin incorrectly stated that U.S. trading would move to Hong Kong or the U.K. if a tax were to be reinstituted in our country, yet both of those jurisdictions already have an FTT in place.[2] Moreover, Sec. Mnuchin neglected to mention that he blamed high-frequency trading (HFT) as a culprit in December 2018 stock market turbulence.[3] We support a tax on trades, in part, to address these disruptions caused by HFT. Yet, this and other benefits of reducing or eliminating high-frequency trading with an FTT were not mentioned.

We ask that you include this letter and our reports in the hearing record.

For questions, please contact Susan Harley at sharley@citizen.org.

Sincerely,
Public Citizen

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[1] Patricia Kowsmann, *Germany Pushes Forward on European Financial Transactions Tax,* THE WALL STREET JOURNAL (Dec. 11, 2019) https://on.wsj.com/2PsX3cn

[2] Michael Edesess, *The Case for a Financial Transaction Tax*, BLOOMBERG (June 20, 2019) https://yhoo.it/34sfbHi

[3] Mark Decambre, *Mnuchin Thinks There's a Simple Reason the Dow is Poised for its Worst December Since 1931,* MARKETWATCH (Dec. 19, 2018) https://on.mktw.net/35ugMhf

AVG ANNUAL FTT COST

INCOME LEVELS	MEDIAN INCOME	COST/ YEAR*
01-19%	$ 15,100	$ 4
20-39%	$ 31,400	$ 9
40-59%	$ 52,700	$ 13
60-79%	$ 86,100	$ 25
80-89%	$136,000	$ 57
90-100	$260,200	$155

*Cost to retirement accounts. Only a small minority of Americans own stocks outside of retirement accounts.

A Progressive Tax With Beneficial Effects

A Small Levy on Financial Transactions Would Steer Clear of Struggling Americans, Raise Meaninful Revenue, and Possibly Retire An Abusive Wall Street Industry

September 16, 2019

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Acknowledgments

This paper was written by Taylor Lincoln, Research Director of the Congress Watch division of Public Citizen, and edited by Susan Harley, deputy director of Congress Watch.

About Public Citizen

Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

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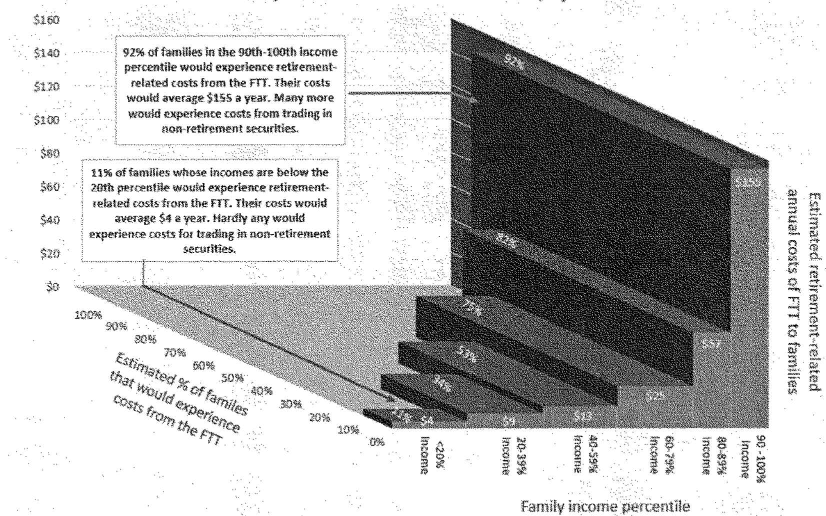
TAKEAWAYS

A small tax on financial transactions, such as a one-tenth of 1 percent levy on the purchase of stocks and bonds, would likely end the viability of high-frequency trading while raising consequential sums for the U.S. Treasury. Opponents of this proposal have claimed it would hinder the ability of middle-class families to save for retirement. In contrast, we conclude that the costs of a modest financial transaction tax (FTT) would be little to nothing for middle-income families and would be easily manageable for average families in top income bracket.

- **Only about half of U.S. families would likely experience any costs at all from a financial transaction tax.** Because only about half the families in the United States have retirement accounts and very few of the families lacking retirement accounts likely own non-retirement securities, about half the families in the country would likely experience no costs at all from a financial transaction tax.
- **An FTT could actually save families money.** Incentives posed by an FTT could result in families saving more money than their costs from the tax. That is primarily because existing overhead and transaction costs that mutual fund investors already pay dwarf their potential costs from the FTT. An FTT would encourage mutual funds to reduce the rate with which they buy and sell stocks. This would not only reduce costs that consumers experience from an FTT, but would yield additional savings in reduced mutual fund overhead and non-FTT transaction costs.
- **An FTT would be progressive.** An average family in the lowest fifth of family incomes (median 2016 earnings of $15,100 a year) that has a retirement account would experience estimated costs of about $4 a year from a one-tenth of 1 percent FTT, according to Public Citizen's estimate. An average middle-income family (median income: $52,700) that has a retirement account would experience about $13 in annual costs. Families in the top 10 percent of incomes (median income: $260,200) would experience about $155 in average costs relating to their retirement accounts, while many would owe additional taxes for trading stocks outside of retirement accounts. [Figure on next page shows the prospective effects of the tax on retirement accounts by income group.] Costs based on estimates issued by the Investment Company Institute, discussed later in this report, would be somewhat higher, but still modest, and similarly progressive in relation to income groups.

Projected Percentages of Familes That Would Experience Retirement-related Costs From 0.1% Financial Transaction Tax, and What Their Costs Would Be, By Income Percentile



INTRODUCTION

Unlike on purchases of most goods, there is no tax on purchases of stocks, bonds or other securities.[1] Over the years, policy advocates and public officials have put forth various proposals to institute a small levy on these transactions.[2]

Such proposals might appeal to those who wish to create a more progressive tax system, raise money for public investments, reduce the federal deficit, or deter high-frequency, computer algorithmic trading.

A financial transaction tax,[3] or FTT, would inherently be targeted toward people of greater means. That is because it would be assessed only on those who have investments in the stock market, and roughly in proportion to the size of investors' assets. Stock ownership is closely correlated with wealth.

Such a tax has the potential to raise meaningful amounts of revenue. The Wall Street Tax Act introduced by Sen. Brian Schatz (D-Hawaii) and Rep. Peter DeFazio (D-Ore.)[4] – which would tax the sale of most stocks, bonds and derivatives at one-tenth of 1 percent – is similar to a proposal that the congressional Joint Committee on Taxation last year estimated would raise $777 billion over a decade.[5]

An FTT also would discourage high-frequency trading. This is a strategy, memorialized in Michael Lewis's best-selling book "Flash Boys," that involves buying and selling securities in intervals of milliseconds based on computer algorithms. High-frequency trading is estimated to account for more than half of stock trades.[6]

High-frequency trading may pose a risk to ordinary investors because the phenomenon of computers acting on other computers' signals could trigger a runaway chain reaction, causing a stock market meltdown. High-frequency traders have been blamed in part for the 2010 "flash crash," in which the Dow Jones Industrial Average lost about 10 percent of its value in 10 minutes for no apparent reason.[7]

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[1] At present, there is a very small fee on transactions that resembles a tax but is not technically a tax. Brokerages often charge a fee, typically less than 10 cents per trade, to cover regulatory fees that they must pay to the Securities and Exchange commission. *See*, for example, *Fees to Consider before Your Sell Your Stock*, FINANCIAL WEB (viewed on Jan. 23, 2014), http://bit.ly/1hPdmY9.

[2] Aside from a financial transaction tax or Wall Street tax, proposals to tax financial transactions have been labeled a Tobin Tax, after Nobel-prize winning economist James Tobin, and the Robin Hood tax, after the folklore hero.

[3] Proposals to institute small levies on financial transactions also have been labeled a Tobin Tax, after Nobel-prize winning economist James Tobin, and the Robin Hood tax, after the folklore hero.

[4] Wall Street Tax Act of 2019, S. 647 (introduced on March5, 2019), http://bit.ly/2MUKnvB and Wall Street Tax Act of 2019, H.R. 1516 (introduced on March 5, 2019), http://bit.ly/2XZrrgm. Separately. Sen. Bernie Sanders (I-Vt.) and Rep. Barbara Lee (D-Calif.) have introduced legislation, the Inclusive Prosperity Act of 2019, that would tax stock trades at 0.5 percent. The analysis in this report is limited to the Wall Street Tax Act because Joint Committee on Taxation has provided an assessment on the amount of revenue that would be raised by a proposal similar to that bill.

[5] Press release, Sen. Brian Schatz, Sen. Schatz, *Rep. DeFazio Introduce New Legislation to Tax Wall Street, Address Economic Inequality* (March 5, 2019), http://bit.ly/2XZsm0i and *Impose a Tax on Financial Transactions*, CONGRESSIONAL BUDGET OFFICE (Dec. 13, 2018), http://bit.ly/2XZcCu4.

[6] Gregory Meyer, Nicole Bullock and Joe Rennison, *How High-Frequency Trading Hit a Speed Bump*, FINANCIAL TIMES (Jan. 1, 2018), https://on.ft.com/2MVw89U.

[7] Andrei Kirilenko, Albert S. Kyle, Mehrdad Samadi, Tugkan Tuzun, *The Flash Crash: High-Frequency Trading in an Electronic Market*, JOURNAL OF FINANCE (forthcoming) (last revised March 10, 2018), http://bit.ly/2IqmXdm.

Setting aside the potential of high-frequency traders to infuse risk into the stock market, the strategies they employ are simply unfair. High-frequency traders enjoy advantages that enable them to receive information and complete orders a split-second sooner than others. This allows them to profit at the expense of other traders.

A financial transaction tax would presumably suffocate the high-frequency trading industry because the tax would largely correlate with trading volume, and high volume is the oxygen of high-frequency trading.

Critics of an FTT, such as mutual fund industry representative Investment Company Institute, have predicted that the tax would hurt all investors "especially middle-income Americans workers saving for retirement."[8]

We find this claim to be unfounded.

By our calculations, an average middle-income family that has a retirement account would experience only about $13 a year in costs from the proposed FTT. (Most families would not pay the tax directly; instead, mutual funds would pay it, and then presumably pass their costs on to their customers.) If we apply the Investment Company Institute's estimates, we conclude that the same average middle-income family would experience about $13 to $35 in annual costs from the tax, depending on the family's mix of investments.

Meanwhile, any costs from the tax would apply only to families that have retirement accounts or other securities. About half of U.S. families do not have retirement accounts, and available data indicate that families without retirement accounts are unlikely to own non-retirement securities. Therefore, about half of U.S. families likely would not experience any costs at all from an FTT.

The effects of the tax would be somewhat different for upper-income Americans, although hardly onerous. About 90 percent of families in the top 10 percent of incomes (median 2016 earnings: $260,200) have retirement accounts. They would experience an average of about $155 a year in costs relating to their retirement accounts from an FTT by our estimate, and between $202 and $564 if the estimates published by the Investment Company Institute are applied. Many in this income strata – unlike those in other income bands – own stocks and other securities outside of retirement accounts and would owe taxes for trading in those assets, as well.

Notably, these estimates do not take into account the near certainty that incentives created by the financial transaction tax would depress trading activity. This would result in actual FTT costs for investors that are lower than those estimated based on current trading volumes. A reduction in trading motivated by the implementation of an FTT would have the salutary effect of reducing mutual fund overhead costs and transaction costs that hinder investors' returns.

Taking these factors into account, it is quite possible that ordinary families would experience net savings after an FTT begins because their savings from reduced trading activity by their funds would exceed the costs that families experience from an FTT.

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[8] Letter from Investement Company Institute CEO Paul Schott Stevens to U.S. Sen. Chris Van Hollen (D-Md.) (March 16, 2016), http://bit.ly/2YQ8snP.

I. AVERAGE ANNUAL RETIREMENT ACCOUNT COSTS RESULTING FROM THE FTT FOR A MIDDLE INCOME FAMILY WOULD RANGE FROM $13 TO $35

Opponents of a modest financial transaction tax have said that it would hurt ordinary families. In this report, we take a close look at the costs that families could expect to experience from a 0.1 percent financial transaction tax. By two methodologies, including one that applies industry estimates, we reach a conclusion that costs to most families would somewhere between trivial and nonexistent.

As stated in the introduction, our estimates do not take into account the near certainty that incentives posed by the tax would dampen stock trading volume, which would result in lower financial transaction taxes than projected in this report, and would yield ancillary savings for consumers.

In both of the methodologies, we estimated the costs to families' retirement accounts from a financial transaction tax according to families' income levels. We focused on retirement accounts because relatively few American families own stocks or other securities that are not held in retirement accounts.

<u>Public Citizen Methodology</u>

We estimated the costs to families from the financial transaction tax by taking the median retirement account size by family income level, as reported by the Federal Reserve, and assuming that families contribute 9.9 percent of their income to their retirement accounts annually. This is the median rate of contribution to retirement accounts, as reported by mutual fund company Vanguard in its most recent annual report on retirement savings. This contribution rate takes into account both employee and employer-financed portions.[9]

We assumed that families would invest in mutual funds with 32 percent annual turnover, the industry average. Mutual fund turnover – which regards the frequency with which funds buy and sell the securities that make up their portfolios – stands to be the primary cause of costs to retirement accounts from an FTT.

We assumed that the FTT would result in costs to family retirement accounts in two ways, each of which concern costs that would be paid by mutual funds and passed on to consumers:

1. Costs relating to mutual funds' purchase and sale of securities

When a mutual fund buys shares of stocks or bonds to change its portfolio or it purchases securities by reinvesting dividends, those purchases would be taxed. We assume that those taxes would be passed on to consumers.

2. Costs relating to consumers' purchases and sales of mutual fund securities

When consumers purchase shares of a mutual fund security, they would not be taxed on the purchase itself under Wall Street Tax Act because new issues of a security are excluded from the tax, and a mutual fund offering would count as a new issue. But consumers' purchases of a mutual fund security could require the mutual fund to purchase the underlying stocks that make up the mutual fund offering. For instance, if the mutual fund's portfolio consisted of all the stocks in the S&P 500, the mutual fund would need to own those underlying stocks to

[9] *How America Saves 2019*, VANGUARD (2019), https://vgi.vg/2L0HOFt.

populate its fund offering. To the extent that the mutual fund experiences more incoming investment than withdrawals, the fund would need to purchase additional stocks on the open market. Those purchases would be taxed.

We are not able to estimate how frequently a fund would need to purchase new shares, as opposed to simply filling orders with the shares freed up by other customers' withdrawals. In this report, to offer a broad interpretation of potential costs to consumers, we assume that the fund would need to purchase new shares each time consumers contribute to their retirement accounts. This assumption almost certainly exaggerates the frequency with which funds would need to purchase shares.

Eventually, families cease to make contributions to their retirement accounts and begin making withdrawals. When families sell shares of mutual funds back to mutual fund management companies, those sales would count as purchases for the mutual fund, and would be taxed under the proposed FTT. Again, we assume that mutual fund companies would pass those costs on to their customers.

For simplicity, calculations for this report assume that families would withdraw funds at the same rate that they previously contributed funds. Therefore, we assume that families that are withdrawing funds from their retirement account would experience the same annual costs from the FTT as those making contributions at the corresponding income levels.

In reality, a family's annual rate of withdrawal would likely differ from its annual rate of contributing. But even if our methodology has significantly underestimated the rate of withdrawal, the effect on our overall conclusion on costs resulting from the FTT would not likely be significant for most families. That is because most of the costs from an FTT would result from mutual funds buying and selling their portfolio securities, rather than from consumers exchanging mutual fund shares.

In this report, we estimate that average families below the 80th income percentile that are withdrawing funds from their retirement account would experience between about $1.50 and $9 in average annual costs from a 0.1 percent FTT associated with their sales of mutual fund shares. Thus, even if families' actual rates of withdrawal proved to be three-times greater than our estimate, they would only experience only about $27 a year in costs for these withdrawals at the high end. By our estimate, families in the top 10 percent of incomes would experience about $25 a year in average annual costs relating to purchases and sales. Thus, they would experience about $75 a year in sales-related costs if their actual rate of withdrawals were three-times greater than our methodology assumes.

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Combining factors 1 and 2, described above, households with retirement accounts that have incomes in the lowest 20 percent (median 2016 income: $15,100) would experience an average of about $4 a year in annual costs from the FTT. But only about one-tenth of these households have a retirement account, and even fewer own non-retirement securities. Therefore, nearly 90 percent of households with incomes in the lowest 20 percent would likely experience zero costs due to a financial transaction tax.

Only about half the families in the middle-income band (median 2016 income: $52,700) have a retirement account. They would pay an average of about $13 per year in financial transaction taxes relating to their retirement account by our methodology. The 47 percent of families in this income band that do not have a retirement account would pay zero, unless they hold stocks or other securities in non-retirement accounts. Only a small percentage of middle-income families own non-retirement securities, and those that do are likely among those that also have retirement accounts.

More than 90 percent of families in the top 10 percent of income (median 2016 income: $260,200) have a retirement account. They would pay an average of about $155 annually in financial transaction taxes relating to their retirement account, according to our methodology. A significant percentage of families in this income band also would owe taxes for trading in other securities. [Table 1]

Table 1: Estimated Costs From Financial Transaction Tax by Income Bracket (Public Citizen methodology)

Income Percentile	Median Income	Pct. of Population in Income Percentile With Retirement Account	Median Retirement Account Size	Estimated Annual Contribution or Sale*	FTT Costs for Retirement Accounts Based on Fund Turnover**	FTT Costs Relating to Family Contributions or Sales	Total FTT-related costs
Less than 20	$15,100	11.3	$7,800	$1,495	$2.50	$1.49	$3.99
20–39.9	$31,400	33.6	$17,000	$3,109	$5.44	$3.11	$8.55
40–59.9	$52,700	53.1	$25,000	$5,217	$8.00	$5.22	$13.22
60–79.9	$86,100	75.2	$51,000	$8,524	$16.32	$8.52	$24.84
80–89.9	$136,000	82.2	$136,000	$13,464	$43.52	$13.46	$56.98
90–100	$260,200	91.9	$403,000	$25,760	$128.96	$25.76	$154.72

Source Public Citizen analysis of Federal Reserve 2016 Survey of Consumer Finances.
* Based median contribution rate of 9.9 percent on income, inclusive of employer and employee contributions, as reported by Vanguard for 2018.[10] ** Assumes 32 percent turnover, the weight-adjusted industry average, according to the Investment Company Institute.[11]

Alternative Methodology: Public Citizen Application of Investment Company Institute Calculations

The methodology above could overestimate the cost of the FTT because it assumes that mutual funds would always purchase component stocks on the open market whenever their customers buy new mutual fund shares. It could underestimate costs because it assumes that retirement savers maintain a "buy and hold" strategy and do not shift their retirement investments from one fund to another. To offer another perspective, we also cross-referenced estimates by the Investment Company Institute on the costs of an FTT against income-sorted retirement account data.

The Investment Company Institute estimated the potential costs of a 0.1 percent FTT by looking backwards at mutual funds' actual activities in 2018. The ICI has only issued its top line findings, not its underlying data. The ICI explained in communications with Public Citizen that the group's estimates were derived by looking at aggregate data on mutual funds' sales and purchases, which the vast majority of mutual funds privately provide to the ICI.

The ICI calculated that a 0.1 percent FTT would have resulted in investors in index mutual funds experiencing annual costs of 0.05 percent of their total investment in 2018. The ICI

10 *Id.*
11 *2019 Investment Company Fact Book*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2Y55A6U.

estimated that investors in average mutual funds (aggregating index funds and actively managed funds) would have experienced FTT-related costs of 0.14 percent of their investment from the FTT in 2018.[12]

When cross-referenced with Federal Reserve data, these estimates lead to a conclusion that families in the middle-income band that have retirement accounts would experience average annual costs relating to the FTT of about $13 if they invested solely in index funds and $35 a year if they invested in a blend of funds that represent a composite of index and actively managed funds. [Table 2]

Table 2: Estimated Costs From Financial Transaction Tax by Income Bracket (Public Citizen Application of Investment Company Institute Calculations)

Income Percentile	Median Income	Pct. of Population in Income Percentile With Retirement Account	Median Retirement Account Size	ICI Estimate of 0.1% FTT Tax Effect on Index Mutual Fund Returns	ICI Estimate of 0.1% FTT Tax Effect on Average of Average Mutual Funds Returns (Index and active)	Annual Costs to Retirement Investors in Index-only Funds	Annual Costs to Retirement Investors in Average Mutual Funds (Index and Active)
Less than 20	$15,100	11.3	$7,800	-0.05%	-0.14%	$3.90	$10.92
20–39.9	$31,400	33.6	$17,000	-0.05%	-0.14%	$8.50	$23.80
40–59.9	$52,700	53.1	$25,000	-0.05%	-0.14%	$12.50	$35.00
60–79.9	$86,100	75.2	$51,000	-0.05%	-0.14%	$25.50	$71.40
80–89.9	$136,000	82.2	$136,000	-0.05%	-0.14%	$68.00	$190.40
90–100	$260,200	91.9	$403,000	-0.05%	-0.14%	$201.50	$564.20

Source: Public Citizen analysis of data issued by the Investment Company Institute and Federal Reserve 2016 Survey of Consumer Finances.

There are some reasons to believe the costs projected in Table 2 are higher than retirement savers should expect. Michael Edesess, an economist, investment strategist and author of books offering investment advice for consumers, commented in an op-ed in *Bloomberg* that consumers' sales and purchases of mutual fund shares in 2018 were unusually large, a factor that would have resulted in higher-than-usual projected FTT costs.[13]

Also, there is evidence that costs from an FTT would be lower for retirement investors than average investors. That conclusion requires a quick summary of the data that mutual funds report. Mutual funds charge their customers fees for their overhead costs that they report as "expense ratios." Funds' expense ratios vary widely and roughly correlate with the frequency with which funds buy and sell stocks in their portfolios. Such buying and selling is reported as their annual "turnover."

[12] Paul Schott Stevens, president and CEO of the Investment Company Institute, letter to Sen. Chuck Grassley, Sen. Ron Wyden, Rep. Richard Neal and Rep. Kevin Brady (March 14, 2019), http://bit.ly/33FXtkN. *Note:* Stevens wrote that a 0.14 percent increase in cost would result in increased overall costs of 31 percent for retirement investors in mutual funds. The 31 percent figure has been widely cited by opponents of the proposal. But it is misleading unless put into context. The fees (officially known as the "expense ratio" costs) covering the average retirement mutual fund investment at the time the letter was written, according to the ICI, were 0.45 percent, or 45 cents for every $100 invested. An increase of 0.14 percent to those costs would indeed represent a 31 percent increase, but it would be 31 percent of a very small number.

[13] Michael Edesess, *The Case for a Financial Transaction Tax*, BLOOMBERG (June 20, 2019), https://bloom.bg/2ZDtasw. (Public Citizen provided a draft of this report to Edesess and incorporated some of his comments.)

Money in 401(k) retirement accounts is invested in funds that have expense ratios about 25 percent lower than the industry average, according to data that the ICI has separately published.[14] Funds with lower expense ratios typically have lower turnover. Funds that have lower turnover will experience lower FTT costs. These facts suggest that retirement accounts would experience lower FTT costs than investors on the whole.

An additional way that the ICI may have overestimated costs from the proposed FTT concerns how sales of securities should be treated. The ICI's calculations assumed that mutual funds would experience FTT costs both on purchases and sale of securities, the ICI told Public Citizen. The Wall Street Tax Act would tax purchases only.[15] The ICI told Public Citizen that it assumed that the market would, in essence, adjust to require sellers to share in FTT costs. This assumption warrants additional review. The public and policymakers could better evaluate the ICI's calculations if it published its underlying math and methodology.[16]

II. THE COST OF AN FTT FOR TRANSACTIONS OUTSIDE OF RETIREMENT ACCOUNTS WOULD BE ZERO FOR MOST FAMILIES

Here, we look at the likelihood of families owing financial transaction taxes due to holdings of securities outside of retirement accounts. Among families below the 80th income percentile, no more than 26 percent hold stock or mutual fund investments. In the 60th to 79th income percentile 13.8 percent of families own stocks and 12.5 percent own pooled investments, which include mutual funds, according to data provided by the Federal Reserve. [Table 3] It is not possible to determine from this data to determine the degree to which the owners of stocks overlap with owners of pooled investments. Because many of the families

[14] *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2GRJVZs and *2019 Investment Company Fact Book*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2Y55A6U.

[15] Wall Street Tax Act of 2019, S. 647 (introduced on March5, 2019), http://bit.ly/2MUKnvB and Wall Street Tax Act of 2019, H.R. 1516 (introduced on March 5, 2019), http://bit.ly/2XZrrgm.

[16] Shortly before this report was published, mutual fund company Vanguard issued a paper that claimed a 0.1 percent FTT would result in a 1.09 percent reduction in annual returns for investors. This estimate was nearly 8 times higher than the estimate put forth by the Investment Company Institute, and it should be viewed with extreme skepticism. In its paper, Vanguard said that FTT costs to consumers would result from increased transaction costs due to fund turnover (presumably taxes) and by the FTT's impact on "market spreads and liquidity" (which likely refers to increased bid-ask spreads, a concept that is discussed later in this paper). Vanguard's paper provides no substantive data, such as the rate of fund turnover or the amount of change to bid-ask spreads it assumed in its model. The paper does say that its estimates are based on investments in a "small-capitalization active equity fund." Selecting such a fund for its model was a strange methodological choice for Vanguard to make, and one that was most likely made to arrive at about the highest possible projected FTT costs. Vanguard is best known as the pioneer of index funds, which have very low annual turnover. For instance, the Vanguard "total stock market index" – which mirrors the entire stock market and has the most assets of any mutual fund in the world – has annual turnover of just 3 percent. Vanguard's "strategic small-cap equity fund," an actively managed small-capitalization fund such as the one Vanguard refers to in its paper, has annual turnover of 88 percent. This rate is nearly 30 times higher than that of its flagship index fund, and would profoundly affect projected FTT costs. But, even if Vanguard assumed an 88 percent turnover rate in its model, that would not come close to explaining the whopping total costs Vanguard claims. By our calculations, annual turnover of 88 percent would result in reduced returns of about 0.1 percent under the proposed FTT. That is less than a tenth of Vanguard's estimated total cost. The rest of Vanguard's cost conclusions, according to the skeletal methodological details the company provides, apparently were derived from an assumption that bid-ask spreads would widen dramatically. As we discuss in Section IV of this report, we believe that it is doubtful that implementation of an FTT would result in expansions of bid-ask spreads that would affect investors' returns much at all. We asked Vanguard for details on the assumptions it made in its model. The company did not provide a substantive response by the time this report was issued.

that own stocks are probably among those that own pooled investments, the percentage holding one type or the other (or both) is likely significantly less than 26 percent.

The percentage of families holding securities outside of retirement accounts rises with income level. In the 90th to 100th income percentile, 46 percent hold stocks and 37 percent hold investments in pooled investment funds. Again, the dataset provides no window into the degree of overlap of these two universes.

Because families' trading practices, unlike mutual funds, are not publicly disclosed and likely vary greatly, it would be difficult to arrive at a *typical* stock-holding family to estimate the effects of an FTT. We can, however, offer some snapshots.

If a middle-income family possessed the median value of stocks and pooled investments for its income band, and if it traded 10 percent of its portfolio in the course of a year, it would owe about $6 in financial transaction taxes annually for these trades. If it traded 30 percent of its portfolio, it would owe about $18 in financial transaction taxes. If it traded 50 percent, it would owe about $30. Note that, at most, only 16 percent of families in the middle-income band (the 40th to 60th percentile of annual incomes) own securities outside of retirement accounts. Therefore, no more than 16 percent could owe any financial transaction taxes for trading non-retirement securities.

Meanwhile, if a family in the 90th to 100th percentile held the median level of both stocks and pooled investments for families in that income band, it would owe about $58 a year in annual financial transaction taxes if it traded 10 percent of its portfolio, $173 if it traded 30 percent, and $288 if it traded 50 percent. [Table 4]

Table 3: Value of Stocks and Pooled Investments Held By U.S. Families by Income Percentile (Non-Retirement Accounts)

Income Percentile	Stocks		Pooled Investment Funds (includes mutual funds)	
	Median Pct. Holding	Median Value	Median Pct. Holding	Median Value
Less than 20	3.9	$7,500	1.6	$20,000
20-39.9	6.0	$15,000	3.2	$90,000
40-59.9	10.5	$8,200	5.4	$50,000
60-79.9	13.8	$12,000	12.5	$61,000
80-89.9	25.1	$21,200	17.6	$120,000
90-100	45.9	$125,000	37.3	$450,500

Source: Federal Reserve 2016 Survey of Consumer Finances.

Table 4: Snapshot of Prospective FTT Costs to Families Trading Securities Outside of Retirement Accounts

Income Percentile	Combined Median Value of Stocks and Pooled Investments	Maximum Pct. of Families That Own Such Investments	Annual FTT Costs for Families That Own Median Level of Both Stocks and Pooled Investments at 10 Pct. Annual Turnover	Annual FTT Costs for Families That Own Median Level of Both Stocks and Pooled Investments at 20 Pct. Annual Turnover	Annual FTT Costs for Families That Own Median Level of Both Stocks and Pooled Investments at 30 Pct. Annual Turnover
Less than 20	$27,500	5.5	$2.75	$8.25	$13.75
20-39.9	$105,000	9.2	$10.50	$31.50	$52.50
40-59.9	$58,200	15.9	$5.82	$17.46	$29.10
60-79.9	$73,000	26.3	$7.30	$21.90	$36.50
80-89.9	$141,200	42.7	$14.12	$42.36	$70.60
90-100	$575,500	83.2	$57.55	$172.65	$287.75

Source: Federal Reserve 2016 Survey of Consumer Finances.

III. CONSUMERS AND FUNDS COULD MORE THAN OFFSET THE COSTS OF AN FTT BY ALTERING INVESTMENT STRATEGIES

The estimates above do not account for incentives created by the FTT to trade less, which would result in families experiencing lower costs from an FTT than shown in these projections. A reduction in trading by mutual funds would likely provide an extra benefit to consumers because it would also reduce non-FTT costs that hinder rates of return.

Mutual funds experience significant transaction costs when they buy and sell stocks. These costs include administrative fees (analogous to "commissions" that consumers pay); costs regarding the discrepancy between what buyers are offering and sellers are demanding (known as the "bid-ask" spread, which is discussed later in this report); and costs relating to the effect on a stock's price of a fund making large quantity purchases or sales (known as the "price impact" or "market impact").

In a 2014 report, we cited three estimates of costs associated with mutual fund transactions. They ranged from 0.4 percent to 0.8 percent of the value of each transaction.[17] If one accepts the midpoint of those estimates, that means investors' essentially lose 0.6 percent of the value of every transaction a fund makes. Because a fund's sale of a stock is usually coupled with a purchase of about equal value, each change to a mutual fund's portfolio, in effect, hits investors with an invisible cost equal to 1.2 percent of the amount in question. Mutual funds, on average, replace about one-third of their portfolios annually. This leads to a conclusion that the average annual hidden costs to consumers from mutual funds' turnover of their portfolios is about 0.4 percent (*i.e.*, one-third of 1.2 percent is 0.4 percent).

Mutual funds also charge their investors official costs, which are reported as "expense ratios," to cover the fund's overhead expenses.[18] The average expense ratio for all mutual funds in 2018 was 0.55 percent of the amount of capital invested.[19]

These figures suggest that investors experience an average reduction in returns from turnover and expense ratios of nearly 1 percent annually (i.e., 0.4% plus 0.55% = 0.95%). That far exceeds potential costs from the proposed financial transaction tax.

Common sense suggests that a financial transaction tax would give mutual funds an incentive to be more judicious about their trading to avoid hindering returns. Evidence from studies on the effects of trading costs on trading volume supports this conclusion.

A researcher for the International Monetary Fund in 2011 reviewed studies that tabulated 20 empirical findings on how changes to transaction costs affected trading volume.[20] In most cases, higher trading costs were associated with reduced trading volume. In about half the cases, the percent reduction in trading volume was the same or greater than the percent increase in trading costs. That means that in about half the cases, traders ended up paying the same or less in total transaction costs even though costs for individual transactions were increased.

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[17] Taylor Lincoln, *A Matter of Perspective*, PUBLIC CITIZEN (March 12, 2014), http://bit.ly/2XSrtK3.
[18] *Expense Ratio*, MORNINGSTAR (viewed on Jan. 27, 2014), http://bit.ly/L1jfpq.
[19] *2019 Investment Company Fact Book*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2Y55A6U.
[20] Thornton Matheson, *Taxing Financial Transactions*, IMF WORKING PAPER (2011), http://bit.ly/1KDCGvK .

Incentives from an FTT will likely cause turnover to decline, reducing the prospective FTT costs and yielding ancillary savings from reduced transactions. The tax could prompt funds to reduce trading enough that reduced transaction costs could more than compensate for the tax.

Families also could reduce their FTT costs – as well as other costs – by choosing lower-cost funds. One way consumers can enjoy lower transaction costs and expense ratio fees is to invest in index funds – sometimes called passive investment funds – which consist of a basket of stocks in a certain universe, such as the S&P 500. Index funds contrast with actively managed funds, in which managers choose securities that they believe will outperform the market. Index funds tend to have much lower turnover and expense ratios than actively managed funds.

Studies have consistently shown that, over time, index funds outperform the bulk of actively managed funds. The chief explanation for this is that actively managed funds need to achieve higher returns to overcome their higher expense ratios and transaction costs. This is difficult to accomplish over the long term.[21]

IV. Factors That Could Increase or Decrease Costs of An FTT That Are Not Discussed Above

There are some additional factors that this report does not attempt to quantify that could result in greater costs or savings to consumers. Although these topics have been the subject of much speculation on the potential effects of an FTT, we believe the impact of these factors would be minimal for ordinary investors.

Increase in bid-ask spreads

If the FTT led, as intended, to the demise of the high-speed trading industry, that would likely result in a modest increase in bid-ask spreads. Bid-ask spreads represent the difference between the highest price that a buyer is willing to pay for a stock and the lowest price a seller is willing to accept. Market makers – who act as middlemen between buyers and sellers – buy at the bid price and sell at the ask price. To draw an analogy, a broker who buys and sells concert tickets for a living might offer to buy (bid for) tickets for $25 and then sell them (ask) at $30. The ticket broker would pocket the difference.

The spreads for stock transactions are much smaller and have fallen to minuscule levels in recent decades. From the latter half of the 1990s through 2004, as Internet trading took hold, bid-ask spreads for high-volume stocks were reduced by an order of magnitude, from about 0.2 percent to about 0.02 percent of the value of a stock offering.[22] This period straddled the 2001 change from markets pricing stocks in fractions of a dollar (such as one-sixteenth of a

[21] *See, for example*, Kent Thune, *Index Funds vs. Actively-Managed Funds*, THE BALANCE (June 2, 2019), http://bit.ly/2Ywxb5i.
[22] See, for example, Terry Hendershott, Charles M. Jones, Albert J. Menkveld, and Matthew O'Brien, *Does Algorithmic Trading Improve Liquidity?* THE JOURNAL OF FINANCE (February 2011), http://bit.ly/2M8wQ25.

dollar) to pennies. Subsequently, pricing in fractions pennies was introduced. The change to decimal pricing enabled tighter bid-ask spreads.[23]

From 2004 until 2011 – the period of the greatest expansion in high-frequency trading[24] – bid-ask spreads for large stocks tightened by another order-of-magnitude, according to data cited in a 2011 speech prominent British economist Andrew G. Haldane.[25]

Experts attribute much of the reduction in bid-ask spreads over recent decades primarily to advances in technology that more efficiently match buyers and sellers, as well as the introduction of more granular pricing.[26] But the expansion of high-frequency trading – which creates a glut of buyers and sellers – also likely played a role in shrinking bid-ask spreads.

An end to high-frequency trading could result in a modest widening of bid-ask spreads. But even if bid-ask spreads returned to levels that existed before the rise of high-frequency trading, costs to ordinary families would be minimal. A return to 0.02 percent bid-ask spreads, which was roughly the average in 2004, would equal only 2 cents per $100 traded.

Demise of High-Frequency Trading Could Result in Non-HFT Traders Obtaining Better Prices

A factor that could save consumers money from an FTT is that the end to high-frequency trading would put conventional mutual funds on equal footing with other traders. This would end the practice of non-high frequency traders being consigned to accepting disadvantageous prices in their securities transactions. As Michael Edesess wrote in his *Bloomberg* op-ed, referenced above, the "lightning trades" by high-frequency firms come at the expense of "whales," like mutual and pension fund traders, who are left to watch desirable offers disappear before they can act on them.[27] Ending the "lightning trades" could result in mutual and pension funds obtaining more favorable prices on the market, benefiting American consumers.

Fallout From FTT Could Cause Mutual Funds to Charge Lower Fees

Also among the factors that could save consumers money from an FTT are that the tax could increase competition within the financial services industry to lower prices. If the FTT put the high-speed trading industry out of business and dampened conventional trading activity, that would likely result in reduced business for the financial services sector. Common sense economic theory holds that those who remained in business would be inclined to lower their prices wherever possible to retain a share of the shrinking market. Therefore, it is

[23] Matthew O'Brien, *Everything You Need to Know About High-Frequency Trading*, THE ATLANTIC (April 11, 2014), http://bit.ly/2YS3ibc and Ben Walsh, *Do stocks really trade for fractions of a penny? Sort of*, REUTERS (Nov. 18, 2013), https://reut.rs/31zmvQF.

[24] Computerized trading has existed since the 1980s. The greatest expansion of high-frequency trading appears to have occurred from about 2004 to 2010. *See, for example*, Michael J. McGowan, *The Rise Of Computerized High Frequency Trading: Use And Controversy*, DUKE LAW & TECHNOLOGY REVIEW (2010), http://bit.ly/2ZFLfGo and Daniel Cross, *The Rise of High-Frequency Trading: A Brief History*, TRADERHQ.COM (July 1, 2015), http://bit.ly/2yKek7C.

[25] Andrew G. Haldane, *The Race to Zero*, Address to the International Economic Association Sixteenth World Congress, in Beijing (July 8, 2011), http://bit.ly/2TiwiHQ.

[26] See, for example, Charles M. Jones, *A Century Of Stock Market Liquidity And Trading Costs* (May 22, 2002), http://bit.ly/2yPYFnm and Josh Bivens and Hunter Blair, *A Financial Transaction Tax Would Help Ensure Wall Street Works for Main Street*, ECONOMIC POLICY INSTITUTE (July 28, 2016), http://bit.ly/30tLXHd.

[27] Michael Edesess, *The Case for a Financial Transaction Tax*, BLOOMBERG (June 20, 2019), https://bloom.bg/2ZDtasw.

conceivable that mutual funds might in essence absorb some of the cost from an FTT, instead of passing it on to their customers, to compete for market share.

CONCLUSION

A financial transaction tax, such as the one proposed in the Wall Street Tax Act, has the potential to raise meaningful amounts of revenue with minimal impact on ordinary Americans. Even its prospective effect on average families in the top income tier is not particularly onerous.

Slamming the breaks on high-speed trading would good for just about all Americans except for those who benefit by treating Wall Street like a casino. Faced with the prospect of less action, Wall Street's croupiers will warn of harms to ordinary Americans from an FTT. Evaluators of those forecasts should consider the industry's incentives.

Those who endorse the concept of a more progressive tax code, meanwhile, should find much to like in a financial transaction tax because it would apply roughly proportionately to families' holdings in securities, and those holdings disproportionately belong to the wealthiest Americans.

Critics of proposed public investments – such as those to improve the nation's health, increase access to education, and address climate change – often base their opposition on affordability grounds. A financial transaction tax would offer a way to make a down payment on long-term investments in the nation's welfare that would be paid almost entirely by those who clearly can afford it.

Warning: How Industry Rigged the Data to Attack Financial Transaction Taxes

October 10, 2019

PUBLICCITIZEN

Acknowledgments

This paper was written by Taylor Lincoln, Research Director of the Congress Watch division of Public Citizen, and edited by Susan Harley, Deputy Director of Congress Watch.

About Public Citizen

Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

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In recent years, several proposals have been put forth to implement a tax of a fraction of a percentage point on the purchase of stocks, bonds and derivatives to fund public investments and to curtail the practice of high-frequency trading.[1]

Public Citizen recently issued a report concluding that a 0.1% financial transaction tax (FTT) would cost an average middle-income family about $13 a year if the family has a retirement account.[2] For the roughly 50% of families that lack retirement accounts, the cost would likely be zero. The report separately applied cost estimates on a 0.1% FTT issued by the Investment Company Institute (ICI), which represents mutual funds. Applying the industry group's estimates yielded a conclusion that the average costs to middle-income families would be about $13 to $35 a year, depending on the family's mix of investments.[3]

These are hardly alarming costs. But interests representing the financial industry have put forth a much different narrative.

Financial industry interests in September issued at least four papers claiming that proposed taxes on financial transactions would seriously harm ordinary Americans. These papers have portrayed proposed FTTs as an attack on "Main Street" and poison for Americans' retirement accounts. Three of the four organizations issuing papers have lobbied against the FTT.[4] (Public Citizen has lobbied in favor of the proposal.[5])

Industry groups have only occasionally issued studies on the FTT in the past. The spate of industry papers arriving at similar findings and employing similar rhetoric, along with overlaps in the membership and principals associated with the various groups, suggests that these papers were part of an orchestrated industry campaign.

The conclusions put forth in these industry papers are not credible. A close look shows that each relied on assumptions that conflict with real world data or omitted key details of its methodology, altogether. To the extent that these papers include descriptions of their methodologies, each suffers from two chief flaws:

- First, the papers use models that assume that the average churn, or turnover, of mutual fund holdings is much greater than it currently is. This is important because much of the cost to investors from an FTT would result from mutual funds' turnover of their portfolios.

[1] See, for example, Wall Street Tax Act of 2019, S. 647, http://bit.ly/2MUKnvB, and H.R. 1516, http://bit.ly/2XZrrgm, and Inclusive Prosperity Act of 2019, S. 1587, http://bit.ly/2lDxdGt,and H.R. 2923, http://bit.ly/2pj2tfd. Note, the United States had a financial transaction tax from 1914 to 1965. In its latter years, this tax was similar to some recent proposals. Critics of financial transaction taxes have cited repeal of the measure as evidence that it did not work as intended. In reality, the FTT was eliminated as part of a massive tax overhaul bill that ended all sorts of excise taxes. See, John D. Morris, *Senate-House Conferees Agree on a $4.6 Billion Excise Tax Cut*, THE NEW YORK TIMES (June 16, 1965).
[2] Taylor Lincoln, *A Progressive Tax With Beneficial Effects*, PUBLIC CITIZEN (Sept. 16, 2019), http://bit.ly/2nLu8Vj.
[3] *Id.*
[4] See lobbying disclosure records maintained by the secretary of the Senate. These reports rarely disclose whether lobbying entities advocate for or against proposals. Based on their public statements, we assume in this report that the entities mentioned have lobbied against the FTT.
[5] *Id.*

Choosing an unrealistically high turnover rate to forecast FTT costs would be like assuming that everybody drives a gas guzzling SUV when predicting an average person's fuel costs.

- Second, these papers ignore the likelihood that incentives from an FTT would reduce trading and, therefore, result in lower FTT costs down the road than recent turnover data suggest. Interestingly, two of the industry papers do say that an FTT would reduce trading volume. But they only discuss reduced trading in the context of their claims that the tax would not generate the anticipated levels of revenue. These papers' forecasts on costs to consumers are based on assumptions that trading will continue at the current pace. This is a clear inconsistency that almost certainly reflects motivations by the reports' authors to cast the FTT in an unfavorable light, rather than to educate the public.

Industry Papers Criticizing Financial Transaction Tax Released in September 2019

Organization Issuing report on FTT	Mutual fund turnover rate in model to project costs	Group's funding source	Group has lobbied on the FTT?
U.S. Chamber of Commerce	63%	Does not disclose. Despite its claims to represent millions of businesses, the Chamber's tax forms in recent years have revealed that the majority of its funding comes from fewer than 100 donors.[6]	Yes
Modern Markets Initiative	67%	Modern Markets was founded, and is funded, by four firms engaged in high-frequency trading.[7]	Yes
Vanguard	Does not disclose. But a Vanguard fund matching the description of the unnamed fund the firm reported that it used in its model has turnover of 88%.	Corporation is funded by revenue from its business.	Yes
Committee on Capital Markets Regulation	N/A. Report did not contain original findings.	Reports that it is funded by "contributions from individuals, foundations, and corporations." Public Citizen asked the Committee if it would provide more specific information. We did not receive a response.	No

[6] See, for example, Dan Dudis, *The Gilded Chamber 2.0*, PUBLIC CITIZEN (2016), http://bit.ly/2nefJkz, and Sam Jewler, *The Gilded Chamber*, PUBLIC CITIZEN (2014), http://bit.ly/2ng7t3J.

[7] E-mail from Modern Markets Initiative CEO Kirsten Wegner to author, Sept. 30, 2019, and study of the four firms that are listed as MMI founders on MMI's web site.

U.S. Chamber of Commerce

On Sept. 16, 2019, the U.S. Chamber of Commerce issued a report on the FTT that it commissioned Georgetown University finance professor James J. Angel to write. The report said that a 0.5% financial transaction tax, as proposed by U.S. Sen. Bernie Sanders (I-Vt.), would result in an average retirement investor accruing about $20,000 less over 46 years.[8]

The Chamber report's calculation assumes FTT costs would result from mutual funds' turnover of their assets. But its model assumes a turnover rate that does not hold up to scrutiny.

The Chamber report assumes that the hypothetical retirement saver would be invested in funds with an annual turnover rate of 63%, which the report says is the "average turnover of a domestic stock fund," according to the mutual fund analysis firm Morningstar.[9] This is an inaccurate statement. The article from which the Chamber report author obtained the 63% figure clearly stated that the number applied only to "*managed* domestic stock funds."[10] The Morningstar number did not take into account index funds.

The Chamber's omission of the word "managed" in its description of the 63% figure is significant because managed funds often have much higher turnover than index funds. Index funds now have about as much money invested in them, if not more, than actively managed funds.[11]

The problems with the Chamber's use of the 63% figure do not end there. The figure reflects a *simple average* turnover of all actively managed U.S. mutual funds, according to Morningstar Research Manager Michael Laske, who issued the figure. That means the figure does not take into account the value of assets invested in each fund. The *asset-weighted average* turnover of managed funds, which does factor in the value of assets each funds holds, is 38%, Laske told Public Citizen.[12]

An asset-weighted average turnover provides much better insight into the costs that an average investor could expect. To draw a hypothetical example, if there were two mutual funds in the world and 99% of mutual fund assets were invested in one fund and 1% in the other, the average investor's experience would correlate much more closely with the fund containing 99% of the assets, not the average of the two. [The response of the author of the U.S. Chamber report is in the footnote below. In some respects, the response appears to validate, rather than allay, concerns we raise about using a turnover figure that ignores index funds.[13]]

[8] James. J. Angel, *Financial Transaction Taxes: A tax on investors, taxpayers, and consumers*, U.S. CHAMBER OF COMMERCE (summer 2019), http://bit.ly/2lCOVtx. Note: Angel's estimates regarded costs to consumers relating to stock transactions. The legislative proposal he analyzed calls for much lower rates of transaction for purchases of bonds and derivatives.
[9] *Id.*
[10] Troy Segal, *Turnover Ratio Definition*, INVESTOPEDIA (March 25, 2019), http://bit.ly/2nRRUPJ.
[11] Dawn Lim, *Index Funds Are the New Kings of Wall Street*, THE WALL STREET JOURNAL (Sept. 18,. 2019), https://on.wsj.com/2m7cHON.
[12] Michael Laske, e-mail to author, Sept. 26, 2019.
[13] Public Citizen sent Chamber report author James J. Angel a summary of our assessment of flaws with the turnover figure he used in his report. We offered to print his response verbatim if he chose to provide one. We also asked if he would correct the error that the Chamber report misstated the universe covered in the 63% mutual fund turnover rate reported by Morningstar's research manager. Angel did provide a response to Public Citizen but did not address our observation that his report mischaracterized the Morningstar figure as including all mutual funds when, in fact, it did not take index funds into account. Here is Angel's response: "Your concern is with the turnover figure, which I

The Investment Company Institute, which represents mutual funds, reported that the asset-weighted average turnover for all mutual funds (i.e., including index funds) in 2018 was just 32%, barely half of the 63% number the Chamber used.[14] This means that if the Chamber report's model were updated to include more accurate turnover data, the FTT costs that it would forecast would be only about half as high as its report concludes.

In reality, turnover levels will likely be even lower in the future, especially if an FTT is implemented. Mutual fund turnover rates are steadily declining. The average asset-weighted annual mutual fund turnover rate from 1984 to 2018 was 56%, which is 75% higher than it was in 2018.[15]

Implementation of any FTT would almost certainly hasten the decline in mutual fund turnover rates simply because it would create a disincentive to trade. This would especially be true for the 0.5% FTT on stocks that the Chamber report analyzed because that rate is at the high end of legislative proposals. Therefore, even plugging in the most recent mutual fund turnover rate of 32% would probably yield an exaggerated estimate of FTT costs.

One portion of the Chamber report trumpets that an FTT would result in reduced trading. Such reduced trading, the report says, means that "the amount of revenue raised will be far less than estimated."[16] But if trading activity is depressed, that would also mean that mutual fund turnover would be reduced and, hence, FTT costs to investors would be lower. The Chamber report ignores this factor in its forecast of costs from an FTT. Instead, it assumes that fund turnover will continue at the current rate, which, as discussed above, the Chamber report also mischaracterizes.

Modern Markets Initiative

Modern Markets Initiative (MMI) issued a report in September that forecast that a 0.5% FTT rate on stocks would impose onerous costs on retirement accounts, university endowments, families' college savings plans, pension plans and retirees.[17]

MMI was founded by high-frequency trading firms and represents the high-frequency trading industry.[18] It advisory board includes James J. Angel, author of the U.S. Chamber of Commerce report discussed above.[19]

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obtained from Morningstar, a respected statistical source. You assert that the turnover figure should be weighted based on fund assets, which skews the number based on a small number of extremely large index funds. The majority of funds offered in 401(k) plans are actively managed, not indexed, so using the simple rather than weighted average is appropriate for illustrating the potential lifetime impact on a worker. The other primary assumptions used in the analysis are quite conservative and tend to reduce the estimated tax hit (i.e. $1,500/year investment, 5% compounding return)."

[14] *2019 Investment Company Fact Book*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2Y55A6U.

[15] *Id.*

[16] James. J. Angel, *Financial Transaction Taxes: A tax on investors, taxpayers, and consumers*, U.S. CHAMBER OF COMMERCE (summer 2019), http://bit.ly/2lCOVtx.

[17] *A Study on the Effects of a Retirement Tax / Financial Transaction Tax on Retirement Security, College Savings and University Investment*, MODERN MARKETS INITIATIVE (September 2019), http://bit.ly/2niRDVr.

[18] *About* page for Modern Markets Initiative (viewed on Sept. 27, 2019), http://bit.ly/2ncLYAq.

[19] *Leadership*, MODERN MARKETS INITIATIVE (viewed on Sept. 27, 2019), http://bit.ly/2nJYpUu.

The MMI report suffers from the same flaws as the U.S. Chamber of Commerce report: it assumes a mutual fund turnover rate that is out of line with actual data and its projections on the FTT's cost to families fail to take into account the likelihood that the FTT would reduce trading activity.

Most of the report's calculations on the costs to families were based on an unsourced assumption of a 67% annual turnover rate for mutual funds, which the report characterizes as the average. MMI later explained in response to a question from Public Citizen that this turnover assumption was derived by averaging three figures on mutual fund turnover.[20] Examination shows that each of these three figures was flawed as a measure of turnover rates that average investors should expect.

- One of the figures (86%) was the simple average turnover rate reported by the Investment Company Institute for 2015.[21] This statistic is flawed because it is several years old, which matters because mutual fund turnover has declined since then. More importantly, it's not weighted for the value of assets invested in each fund. The ICI report from which this number was drawn explains why a simple average is not the best lens. In the sentence after reporting the 86% simple average, the ICI wrote "however, mutual fund shareholders tend to invest in equity funds with much lower turnover rates, as reflected in the lower industrywide *asset-weighted* average turnover rate of 44%."[22] [emphasis added] As noted above, the ICI reported that the asset-weighted average fell to 32% in 2018.[23]

- A second figure was the 63% turnover rate reported by Morningstar's research manager for actively managed domestic funds.[24] As described above, use of this figure is flawed as a predictor of expected costs for average investors because it does not include index funds and because it is a simple average, not a weighted average.

- The third figure cited was a reference in a blog by a financial investor on the web site *ETF Trends*. The blog said that median turnover for mutual funds is "about 50 percent."[25] The blog author does not describe the source of this statistic, so it is impossible to assess its credibility. More importantly, median turnover rates embody many of the same problems as simple averages when it comes to projecting the costs of an FTT on an average investor. While a median offers the benefit of diminishing the effects of outliers, it does not take into account the amount of money invested in given funds the way that an asset-weighted average does.

Similar to the claims in the U.S. Chamber of Commerce report cited above, MMI's report expresses a prediction that an FTT would result in reduced trading volume.[26] But, as with the Chamber report, the MMI report only invokes reduced trading in the context of a prediction that an FTT would not yield as much revenue as expected. It does not take the anticipated reduction in trading volume into

[20] E-mail from Modern Markets Initiative CEO Kirsten Wegner to author, Sept. 19, 2019.
[21] *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2015*, INVESTMENT COMPANY INSTITUTE (July 2016), http://bit.ly/2marxEd.
[22] *Id.*
[23] *2019 Investment Company Fact Book*, INVESTMENT COMPANY INSTITUTE (2019), http://bit.ly/2Y55A6U.
[24] Troy Segal, *Turnover Ratio Definition*, INVESTOPEDIA (March 25, 2019), http://bit.ly/2nRRUPJ.
[25] Rusty Vanneman, *ETF Analysis: Don't Forget Portfolio Turnover*, ETF TRENDS (Dec. 27, 2016), http://bit.ly/2mmitvV.
[26] The MMI report says that the FTT has "a proven track record of failure in the jurisdictions in which it has been tested," in part due to its effect of "reducing trading volume by 50 to 80%."

account in its forecast of FTT costs to investors. Reduced trading would, of course, reduce FTT costs, as well as other transaction-related costs. [MMI's response is in the footnote below.[27]]

Vanguard

The mutual fund company Vanguard issued a paper in September claiming that a 0.1% FTT would reduce investors' returns by a staggering 1.09% a year.[28] (Note: the 0.1% proposed tax on stock trades that Vanguard's paper assessed is only one-fifth as large as the 0.5% proposed tax assessed in the U.S. Chamber of Commerce and MMI reports, above.) Costs to investors from a 0.1% FTT, Vanguard claimed, would require the "everyday investor to work roughly two-and-a-half years longer before retiring."[29]

The Vanguard paper appears to be riddled with even greater methodological flaws than the U.S. Chamber of Commerce and Modern Markets Initiative reports discussed above. This is in part because the Vanguard paper appears to rely on an assumed mutual fund turnover rate that is even further removed from reality than those used in the Chamber and MMI papers. Worse, even if one accepts its assumption of an abnormally high mutual fund turnover rate, the Vanguard paper still fails to account for the vast majority of costs that it forecasts for an FTT.

The Vanguard paper provides scant information about the methodology underlying its conclusions. But it does divulge that its calculations are based on an investment in "a small capitalization active equity fund."[30] Vanguard's decision to use an actively managed fund in its model should strike any reader with a casual familiarity of mutual funds as highly suspicious. Vanguard, of course, is famous for its pioneering role in developing low-cost, low-turnover *index* funds, which are the opposite of the type it chose for this paper.

Vanguard's paper does not disclose the exact fund or turnover rate it used in its model. But Vanguard's "Strategic Small-cap Equity Fund,"[31] which is the kind of fund the company says it modeled its FTT calculations on, has annual turnover of 88%.[32] Vanguard's Total Stock Market Index Fund (its flagship index fund and often reported as the biggest mutual fund in the world) has

[27] Public Citizen submitted a summary of these criticisms to Kirsten Wegner, the CEO of Modern Markets Initiative, and offered to print her response verbatim in this report. Wegner did respond, though she did not address the substance of the issues we raised on the method by which MMI arrived at a turnover figure to plug into its model. Here is Wegner's response: "Modern Markets Initiative (MMI) is pleased to provide open and transparent information on MMI's Financial Transaction Tax (FTT) calculations and why it is a retirement tax on hard working Americans at all levels of income trying to save for the future. MMI's turnover calculation of 0.67 for a mutual fund in a 401k plan was arrived at utilizing three publicly available data points: 0.86 from ICI, 0.63 from Morningstar, and 0.5 from ETF Trends. Further, as noted in MMI's report in footnote 13, MMI provides a calculation were a turnover to be calculated at 0.5 turnover rate, to highlight that impact of an FTT even utilizing the most modest data point would still arrive at over $40,000 lifetime impact out of a portfolio of $80,000 invested in the stock market (subject to the 50 basis point tax). MMI's footnote includes a hypothetical calculation for an investor with $100,000 saved over 40 years, of which 20% is invested in bonds and 80% (or $80,000) in equities subject to the 50 basis point tax; this calculation notes a 0.5 turnover rate (e.g. conservative, less than the 0.67 average mutual fund rate), such that $40,000 of the stocks are subject to the FTT a year; that had that $200+ been invested rather than tax, the participant would retire with an extra $45,717 after 40 years."
[28] *Main Street investors at risk*, VANGUARD (September 2019), http://bit.ly/2nbYFLW.
[29] *Id.*
[30] *Id.*
[31] See, Vanguard Strategic Small-Cap Equity Fund, https://vgi.vg/2n9zIRb.
[32] Vanguard Strategic Small-Cap Equity Fund Investor Shares, Yahoo Finance! (profile), https://yhoo.it/2n9ALAB.

turnover of just 3%.[33] In other words, Vanguard apparently chose to base its estimates on a fund with about 30 times higher turnover than the type of fund the company is best known for.

Vanguard's Total Stock Market Index has about $827 billion invested in it.[34] That's more than 500 times greater than its Strategic Small-cap Equity Fund, which has just $1.4 billion in assets (both figures as of Oct. 8, 2019).[35] This discrepancy casts further doubts on the legitimacy of Vanguard's decision to use a fund like its Strategic Small-cap Equity Fund to predict FTT costs for ordinary investors.

Vanguard's paper explains that its cost estimate for a 0.1% FTT takes into account two costs: 1. "transaction costs that would be incurred due to fund turnover" and 2. "the estimated impact the FTT would have on market spreads and liquidity."[36]

Even plugging in a fund turnover rate as high as 88% would only account for an annual reduction in returns of about 0.09% under a 0.1% FTT. That is less than a tenth of the costs that Vanguard's paper forecasts for the FTT.

That leaves "market spreads and liquidity," the second factor Vanguard cites in its explanation of FTT costs, to explain the vast majority of costs that Vanguard claims would result from a 0.1% FTT. This factor presumably refers to a theory that reduced trading from an FTT could increase the discrepancy (or spreads) in the prices that buyers and sellers offer in stock transactions.

Bigger market spreads do result in higher transaction costs, but the gradations can be so small that increases are not likely to have a meaningful effect on ordinary investors. Vanguard's paper provides no details on how much its authors expect market spreads would expand under an FTT. It is almost inconceivable, however, that spreads could expand anywhere near enough to account for the staggering costs that the Vanguard paper forecasts for a 0.1% FTT.

Market spreads have generally fallen over time and have shrunk to microscopic levels (on the order of 0.002%)[37] in the past decade. Some attribute this tightening to the rise of high-frequency trading, which creates a glut of buyers and sellers. But if spreads reverted to their level in the early-2000s, which was before high-frequency trading took off, the extra costs to investors would still be tiny.[38] Spreads began to shrink markedly earlier than that, when the advent of Internet trading greatly increased the efficiency of matching buyers and sellers. But even if spreads reverted all the way back to pre-Internet, early-1990s levels, the increased costs to investors would still only account for a fraction of the costs that Vanguard projects for the FTT.[39]

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[33] Vanguard Total Stock Market Index Fund Investor Shares, Yahoo Finance! (profile), https://yhoo.it/2njuceH.
[34] *Id.*
[35] Vanguard Strategic Small-Cap Equity Fund Investor Shares, Yahoo Finance! (profile), https://yhoo.it/2n9ALAB.
[36] *Main Street investors at risk*, VANGUARD (September 2019), http://bit.ly/2nbYFLW.
[37] See, for example, Andrew G. Haldane, *The Race to Zero*, Address to the International Economic Association Sixteenth World Congress, in Beijing (July 8, 2011), http://bit.ly/2TiwiHQ.
[38] See, for example, Terry Hendershott, Charles M. Jones, Albert J. Menkveld, and Matthew O'Brien, *Does Algorithmic Trading Improve Liquidity?* (June 2008) (Slides), http://bit.ly/2mkW1Dq.
[39] *Id.*

Public Citizen asked Vanguard's communications staff several times for details on the assumptions and methodology underlying the findings of the company's paper, such as the turnover rate and the extent of change in market spreads that the paper assumed. We did not receive a substantive response.

We did learn in the course of this research that Vanguard produced at least one previous study on the FTT, in 2015. That study, according to a *New York Times* article that referenced it, arrived at a conclusion that a 0.1% FTT could reduce returns by up to 1.62% annually, an even more mind-boggling conclusion than the recent Vanguard paper claimed.[40]

The *New York Times* article included details about the 2015 study that provide insight into the strategically misleading nature of Vanguard's methodology. The article said that Vanguard's projected 1.62% cost would occur in the case of "an actively managed mutual fund that buys small stocks."[41] This is the type of fund Vanguard plugged into its model in its recent paper. Vanguard's 2015 paper concluded that costs for an actively managed fund that buys large stocks would be just 0.58%, according to the *Times*.[42]

The significantly lower costs for large-stock funds likely explains why Vanguard did not include calculations for such funds in its recent paper. Meanwhile, the *Times* article reported that Vanguard's "index funds would probably suffer less" under the FTT. But, tellingly, the *Times* reported that "the company did not run those numbers."[43]

Observers should look upon Vanguard's FTT conclusions regarding all types of funds with great skepticism, especially if the company continues to keep secret the details on how it reached its conclusions. But the company's mere choice to focus on actively traded funds and ignore index funds should suffice to reveal its true purposes in issuing these papers.

The Committee on Capital Markets Regulation

The Committee on Capital Markets Regulation published an 18-page report in September forecasting all manner of harms from an FTT. The Committee is a 501(c)(3) nonprofit group that consists of 35 individuals, most of whom are high ranking officials at financial institutions and a few of whom are associated with esteemed universities, including Harvard and Columbia.[44]

Hal Scott, the president and CEO of the Committee and an emeritus professor at Harvard Law School,[45] was paid $500,000 by the Committee in 2018 for 30 hours of work per week, according to the Committee's tax form for that year.[46] Co-chair Glenn Hubbard is a former chairman of the

[40] Ron Lieber, *A Tax to Curb Excessive Trading Could Be a Boon to Returns*, THE NEW YORK TIMES (Oct. 2, 2015), https://nyti.ms/2nwx9sO. (Public Citizen asked Vanguard to send us its 2015 study. We did not receive a response.)
[41] *Id.*
[42] *Id.*
[43] *Id.*
[44] *Financial Transaction Taxes*, COMMITTEE ON CAPITAL MARKETS REGULATION (September 2019), http://bit.ly/2ne6GA1.
[45] Hal S. Scott, *Nomura Professor of International Financial Systems, Emeritus*, HARVARD LAW SCHOOL (viewed on Sept. 27, 2019), http://bit.ly/2nQ4eQk and Committee on Capital Markets Regulation Form 990 (2018), http://bit.ly/2mp54TJ.
[46] Committee on Capital Markets Regulation Form 990 (2018), http://bit.ly/2mp54TJ.

White House Council of Economic Advisers under President George W. Bush and former dean of the Columbia University Business School, where he still serves as a professor and dean emeritus.[47]

The Committee's report on the FTT did not include original findings or claims but, instead, summarized those that others have put forth. The Committee's report relayed three findings on prospective FTT costs that it attributes to other organizations. The report characterized those findings as much more substantive and official than they actually were.

The three claims outlined in the Committee's report were:

- The Committee reported that a 0.1% FTT could, according to the American Retirement Association, "reduce an American's retirement savings by as much as 3% over their working life."[48] The footnote cites to an opinion piece and indicates "(quoting the CEO of the American Retirement Association, Brian Graff)."[49] In reality, there are no quotation marks around the words in question in the opinion piece, nor does the opinion piece indicate that the author is paraphrasing Graff. A literal reading would indicate that the analysis belonged to the author of the opinion piece, not Graff, although the proximity of the words to those that did quote Graff could lead a reader to infer that the author was putting forth Graff's thinking. The unquoted words, in turn, impute costs to an FTT based on an Obama-administration report on an entirely different topic.[50] No additional elaboration or detail is provided. The American Retirement Association has reported lobbying on the financial transaction tax (presumably against it) in 2019.[51]

- The Committee reported that the Securities Industry and Financial Markets Association (SIFMA) "estimates that '[a] typical mutual fund investor will have to save an additional $600 per year...or work an additional two years to achieve his/her retirement goals.' "[52] What work, if any, SIFMA did as an organization to arrive at that estimation is unclear from the Committee's report. The quotation in the Committee's report cites to a June 13, 2019, opinion piece that was written by SIFMA CEO Kenneth E. Bentsen Jr.[53]

  It appears that the claims in Bentsen's op-ed did not originate with anybody at SIFMA. We pasted the relevant portion of Bentsen's op-ed into an e-mail to a SIFMA spokeswoman and asked the source of Bentsen's claim, particularly the culminating sentence of the opinion piece that said costs from an FTT could reduce returns by up 1.62% annually. A SIFMA spokeswoman told Public Citizen by e-mail that the source of Bentsen's conclusion

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[47] *Id. and Glenn Hubbard*, GLENNHUBBARD.NET (viewed on Oct. 4, 2019), http://bit.ly/2MbHJhr.
[48] *Financial Transaction Taxes*, COMMITTEE ON CAPITAL MARKETS REGULATION (September 2019), http://bit.ly/2ne6GA1.
[49] *Id.*
[50] Nevin Adams, *Financial Transaction Tax Attacks Retirement Savings*, AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES (March 26, 2019), http://bit.ly/2n9XInf. See, also, *About ASPPA*, AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES (viewed on Sept. 27, 2019), http://bit.ly/2nkADOE.
[51] Lobbying disclosure records maintained by the secretary of the Senate. See, for example, http://bit.ly/2nQ90NK.
[52] *Financial Transaction Taxes*, COMMITTEE ON CAPITAL MARKETS REGULATION (September 2019), http://bit.ly/2ne6GA1.
[53] Kenneth E. Bentsen Jr., *The Facts Don't Support the FTT*, SIFMA (June 13, 2019) (archived version), https://web.archive.org/web/20190915045346/https://www.sifma.org/resources/news/the-facts-dont-support-the-ftt/. http://bit.ly/2mnV39k

was the 2015 Vanguard study that is referenced earlier in this paper.[54] We asked SIFMA's spokeswoman if she could send us a copy of the Vanguard study. We did not receive a response.

In fact checking for this report, we attempted to confirm that the words in Bentsen's June 13, 2019, opinion piece matched those in the Committee's report. We located the opinion piece, which was still dated June, 13, 2019. But, mysteriously, the language that is cited in the Committee of Capital Markets report was not there. We then discovered that all of the language in the paragraph from Bentsen's June 13, 2019, opinion piece that the Committee's report cited has been updated to reflect the claims in the paper that Vanguard released in September 2019 (discussed above).[55]

- The third cost forecast in the Committee's report is that "BlackRock estimates that a 10 basis-point FTT would cause investors to lose $2,300 in expected returns on a $10,000 investment in its global equity fund over ten years."[56] The Committee's report does not cite BlackRock as the source of this claim but, rather, a 2013 article in *The New York Times* by Steven Solomon, a professor at the University of California, Berkeley.[57] Public Citizen was unable to obtain any document or statement by BlackRock that referred to such a finding. Public Citizen inquired to the Committee and to BlackRock in search of BlackRock's work, but to no avail. Because we were unable to locate any documentation for the claim that the Committee report attributes to BlackRock, we are unable to assess its credibility. [The president of the Committee indicated to Public Citizen that the Committee relied on Solomon's article, not BlackRock, for the findings it attributed to BlackRock. The Committee president's full response is in the footnote.[58]]

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[54] E-mail from SIFMA's Lindsay Gilbride to author (Sept. 30, 2019).

[55] Kenneth E. Bentsen Jr., *The Facts Don't Support the FTT*, SIFMA (June 13, 2019) (updated version), http://bit.ly/2mnV39k and *Main Street investors at risk*, VANGUARD (September 2019), http://bit.ly/2nbYFLW.

[56] *Financial Transaction Taxes*, COMMITTEE ON CAPITAL MARKETS REGULATION (September 2019), http://bit.ly/2ne6GA1

[57] Steven Davidoff Solomon, *In Wall St. Tax, a Simple Idea but Unintended Consequences*, THE NEW YORK TIMES (Feb. 26, 2013), https://nyti.ms/358D2h3.

[58] Public Citizen submitted questions by e-mail regarding the Committee's report to Harvard University emeritus law professor Hal Scott (who is the president and CEO of the Committee), to Columbia University professor and Columbia Business School Dean Emeritus Glenn Hubbard (who is a co-chair of the Committee) and to Committee on Capital Markets Regulation Executive Director John Gulliver. Among other questions, we asked these leaders if they were comfortable that the Committee did sufficient due diligence to confirm that the figures its report imputed to SIFMA, the American Retirement Association and BlackRock are credible. We also asked them if the Committee would correct its claim in its report that "SIFMA" arrived at various conclusions on an FTT, given that those conclusions did not originate with SIFMA. We did receive a response from Hal Scott, but his response did not address the substantive issues we raised. In his e-mail, Scott appears to indicate that finding that the paper attributes to BlackRock was actually the finding of a professor articulated in the *New York Times*. Contradictorily, however, Scott maintained that the Committee report's description is accurate. Here is his response: "Throughout the Committee's 14 page report we explain the key factors that form the methodological basis for econometric studies of FTTs. These factors include the direct cost of the tax on retirees and investors, negative impact on market liquidity and increase in the cost of raising capital for U.S. companies and the U.S. government. Additionally, the paragraph that you reference in your October 2 email correctly attributes estimates of the impact of an FTT on retirees and investors to the CEO of SIFMA, the CEO of the American Retirement Association and Berkeley Professor Steven Solomon. However, as to the statement by the CEO of SIFMA, we cite to a June 13, 2019 statement that has since been updated. In fact, we should reference a related July 29, 2019 statement." [Scott's e-mail did provide that July 29, 2019 statement.]

SIFMA's CEO and a BlackRock representative are members of the Committee on Capital Markets Regulation.[59] Glenn Hubbard, a co-chair of the Committee, is on the board of BlackRock.[60] Also on the Committee is the managing director of high-frequency trading firm Hudson River Trading. Hudson River Trading was one of the founders of the Modern Markets Initiative, which wrote one of the other reports attacking financial transaction taxes, as discussed above.[61]

Conclusion

The industry groups that have put forth reports attacking financial transaction taxes clearly are self-interested. Their suggestions that they are motivated by concerns for retirees or "Main Street" should be ignored.

The financial industry, if nothing else, has professionals at its disposal who are expert at modelling and making precise calculations. They are capable of getting their facts right. These groups' reliance on inaccurate data and mystery methodologies to arrive at their conclusions on the potential costs of FTT proposals should prompt evaluators to look upon every assertion made in these reports with great skepticism.

[59] Members, COMMITTEE ON CAPITAL MARKETS REGULATION (viewed on Sept. 27, 2019), http://bit.ly/2mMomYUDB.
[60] Co-chairs and President. COMMITTEE ON CAPITAL MARKETS REGULATION (viewed on Oct. 2, 2019), http://bit.ly/2nWndZT.
[61] *About* page for Modern Markets Initiative (viewed on Sept. 27, 2019), http://bit.ly/2ncLYAq.