Testimony of Richard W. Painter
Before the Committee on Oversight and Government Reform
United States House of Representatives
Hearing entitled
Legislative Proposals for Fostering Transparency
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Mr. Chairman, Ranking Member and Members of the Committee:

I am here to testify in support of the OPEN Government Data Act, and with some qualifications the Fannie and Freddie Open Records Act and the Federal Reserve Transparency Act. I will address the latter two bills in more detail in this testimony.

I have spent most of my career in law practice and law teaching in the field of financial services regulation. As I discuss in my 2015 coauthored book on bankers' ethics[1], I believe strongly that transparency and accountability are critical to the health of the financial services industry and the American economy which depends upon safe and sound financial services.

For this reason I support, in concept at least, both the Fannie and Freddie Open Records Act and the Federal Reserve Transparency Act.

Fannie Mae and Freddie Mac

These two mortgage giants, through mismanagement and concealment, contributed substantially to the financial collapse of 2008. That story has already been told, including in my own book[2], and I will not retell it here.

[1] Bettter Bankers, Better Banks: Promoting Good Business Through Contractual Commitment (U Chicago Press 2015) (with Claire Hill)
[2] Id.

Increased transparency at both institutions will go a long way toward avoiding a repeat of past mistakes. Public access to records – whether through the Freedom of Information Act or other similar means – will help assure sound management and safe practices in their business of securitizing home mortgages.

Fannie Mae and Freddie Mac, however, were not alone in causing the financial crisis. Many other institutions, most of them publicly held corporations traded on the New York Stock Exchange, participated in the securitization of bad mortgage loans and foisting them off on unsuspecting investors. Some of the most prominent institutions – Lehman Brothers, Merrill Lynch and Bear Stearns – were managed so badly that they became insolvent and either declared bankruptcy or were bailed out by the federal government and merged into other institutions. Public financial disclosure by these companies on Forms 10-K and other filings with the Securities Exchange Commission was very inadequate and arguably fraudulent.

It would make little sense – and indeed be very hypocritical – for Congress to impose greater transparency measures on Fannie Mae and Freddie Mac without imposing similar measures on other financial institutions that securitize billions of dollars of mortgages and other debt and that, through their business practices, have a similar impact on our economy.

I am not suggesting that these large financial institutions be subject to the Freedom of Information Act or similar laws focused on governmental entities, but a very good argument can be made for giving shareholders in these companies similar access to information that would be available from Fannie Mae and Freddie Mac under this bill. If this bill or other legislation does not give shareholders such a right to specific information going beyond the general statements made – and sometimes misrepresented -- in annual disclosure Form 10-K and other securities filings, the

sloppy business practices that characterized the entire industry for so long will simply migrate from Fannie Mae and Freddie Mac, where there will be more disclosure on account of this new law, over to other parts of the financial services industry where there will be less disclosure. This will not only create an uneven playing field disadvantaging Fannie Mae and Freddie Mac, but could have potentially disastrous consequences for investors, for the economy and American workers.

In sum I am in favor of more transparency and open records, but across the entire industry of mortgage securitization, not just at Fannie and Freddie.

The Federal Reserve

The Federal Reserve also is an institution in need of greater transparency. Markets are more stable if investors are not taken by surprise by decisions made by the Fed. Transparency reduces the risk of scandal because information that is withheld by the Fed is prone to leaks and potential abuse in insider trading. Finally, economists, investors and the public should be aware of factors considered by the Fed in setting interest rate policy as well as the Fed's stance on regulatory matters. There are legitimate and important differences of opinion on these matters, and sound policy is most likely to emerge from robust public debate.

On the other hand, protection of the Fed's independence from the elected branches of government is critical. The Fed's mission is to promote sound long term economic growth and minimize inflation. The Fed's role is not to time growth cycles to correspond with election cycles for the President or Members of Congress. Neither is the Fed charged with being a propaganda ministry for the executive branch, telling people that the economy is doing better than it is. The political branches of government can live in an "alternative facts" universe if they so choose and voters tolerate it.

The Fed's job is to tell the truth about economic facts because investors need this information. Indeed, it is a crime for anyone, including a person associated with the Fed to knowingly or recklessly make a false statement that affects the price of a publicly traded security.[3]

By sharp contrast to the level of care in stewardship of the economy and candor expected of the Fed, we see hyperbole at best, as well as extremely short time horizons in the elected branches of government. The President – not yet two months in office – has Tweeted about jobs statistics linked to policies in place long before he took office. We regularly see August and September job statistics given disproportionate weight in economic policy debates in November elections, with one candidate claiming the economy is going gangbusters and the other insisting that we are veering into a recession. The Fed should have no role in such political theatre. In order to assure that the Fed stays well clear of such politicized economics, it is critical that the Fed continue to be as independent as possible from the Executive and Legislative branches of government.

A balance thus must be struck between accountability and transparency of the Fed on the one hand, and independence of the Fed on the other. I believe this bill strikes the right balance, but I strongly urge that this Committee solicit the opinions of present and past members of the Federal Reserve Board to make sure that this bill does not undermine the independence of the Fed or otherwise interfere with Fed policy. It should be possible to achieve accountability and transparency at the Fed while preserving the Fed's independence, and if this Committee is careful in its deliberations over this bill, and with the details embedded therein, that balance can be achieved.

[3] See Section 10b of the 1934 Securities Exchange Act and Rule 10b-5 thereunder.

Transparency and Accountability Expectations of Federal Officials

In addition to the transparency and accountability expectations of Fannie Mae, Freddie Mac and the Federal Reserve that are set forth in these bills, Congress needs to consider amending federal financial disclosure laws for executive branch officials to require more transparency in their own financial dealings, particularly dealings with large lending institutions.

Unfortunately, the public financial disclosure form 278 filed by senior executive branch officials does not require disclosure of borrowing and other infusions of capital at the corporate level for entities owned in whole or in part by the public official. The entity itself is listed on Schedule A of Form 278 but its debt obligations and other capital infusions are not listed on Schedule B (liabilities) unless the office holder himself or herself is liable on the debt which is rarely the case. This means that office holders through undisclosed corporate level debt or other capital infusions could be financially dependent upon persons and entities unknown anywhere in the world. This raises serious questions under the Emoluments Clause of the Constitution if foreign sovereign wealth funds or state owned banks are involved, and in any event is a serious deficiency in the transparency we ordinarily expect of public officials.

This issue is most pronounced in the public financial disclosure form 278 of President Trump, particularly when coupled with his refusal to disclose his tax returns. But this is an issue likely to affect other high net worth public officials as well. Such a disclosure lapse with respect to large scale corporate level transactions in entities controlled by public officials is unacceptable in a government where transparency is critical for there to be accountability.

Congress should amend the disclosure statute to require disclosure of debt and other capital infusions into privately held entities that are majority owned by public officials filing Form 278, including but not limited to the President of the United States. I would be pleased to discuss specifics of such an amendment in answer to your questions.

Because much of this information can be obtained from the tax returns of a person controlling such entities, I would also strongly support legislation requiring senior public officials, including the President, to disclose their tax returns.

Thank you

Richard W. Painter

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Professor Richard W. Painter received his B.A., summa cum laude, in history from Harvard University and his J.D. from Yale University, where he was an editor of the *Yale Journal on Regulation*. Following law school, he clerked for Judge John T. Noonan Jr., of the United States Court of Appeals for the Ninth Circuit and later practiced at Sullivan & Cromwell in New York City and Finn Dixon & Herling in Stamford, Connecticut.

He has served as a tenured member of the law faculty at the University of Oregon School of Law and the University of Illinois College of Law, where he was the Guy Raymond and Mildred Van Voorhis Jones Professor of Law from 2002 to 2005.

From February 2005 to July 2007, he was Associate Counsel to the President in the White House Counsel's office, serving as the chief ethics lawyer for the President, White House employees and senior nominees to Senate-confirmed positions in the Executive Branch. He is a member of the American Law Institute and is an advisor for the new ALI Principles of Government Ethics. He has also been active in the Professional Responsibility Section of the American Bar Association.

Professor Painter has also been active in law reform efforts aimed at deterring securities fraud and improving ethics of corporate managers and lawyers. A key provision of the Sarbanes-Oxley Act of 2002 requiring the SEC to issue rules of professional responsibility for securities lawyers was based on earlier proposals Professor Painter made in law review articles and to the ABA and the SEC. He has given dozens of lectures on the Sarbanes-Oxley Act to law schools, bar associations, and learned societies, such as the American Academy of Arts and Sciences. Professor Painter has on four separate occasions provided invited testimony before committees of the U.S. House of Representatives or the U.S. Senate on securities litigation and/or the role of attorneys in corporate governance.

His book, *Getting the Government America Deserves: How Ethics Reform Can Make a Difference*, was published by Oxford University Press in January 2009. He has written op-eds on government ethics for various publications including the *New York Times*, the *Washington Post* and the *Los Angeles Times*, and he has been interviewed several times on government ethics and corporate ethics by national news organizations, including appearances on Lawrence O'Donnell (MSNBC), Anderson Cooper 360 (CNN), CNN News, Fox News, National Public Radio All Things Considered, and Minnesota Public Radio News. In 2011, he testified before the U.S. House Government Oversight Committee on partisan political activity by government officials

and reform of the Hatch Act. Professor Painter has also given expert testimony in cases involving securities transactions and the professional responsibility of lawyers. He testified as a defense witness in *SEC. v. The Reserve Money Market Fund* (SDNY, November 2012), a jury trial of an SEC enforcement action against the founders of the world's oldest money market fund that ended with a defense verdict on all of the fraud counts.

Professor Painter is the author of two casebooks: *Securities Litigation and Enforcement* (with Margaret Sachs and Donna Nagy; West 2003; Second Edition, 2007; Third Edition 2011) and *Professional and Personal Responsibilities of the Lawyer* (with Judge John T. Noonan Jr.; Foundation 1997; Second Edition, 2001; Third Edition 2011). He has written dozens of articles, book reviews, and essays, including a series of papers and a forthcoming book with Minnesota colleague Claire Hill on the personal responsibility of investment bankers.

During the 2014-15 academic year, Professor Painter will be on leave as a fellow at Harvard University's Safra Center for Ethics where he will work on a book on campaign finance reform.