



**Americans for Financial Reform**  
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October 23, 2013

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to H.R. 992, the “Swaps Regulatory Improvement Act”.<sup>1</sup> It is important to be clear about exactly what this bill would do: it would change the law to permit public support of swaps dealing activities at some of the largest banks on Wall Street. At a time when there is bipartisan agreement that subsidies to too-big-to-fail banks must end, this legislation moves in exactly the wrong direction. If the experience of the financial crisis was not enough, the recent derivatives losses at JP Morgan’s London branch should remind us again that a deposit insurance backstop to derivatives speculation at giant financial institutions is a bad idea. That is what H.R. 992 would permit and that is why it must be rejected.

HR 992 would weaken the ‘swaps push out’ provision (Section 716) of the Dodd-Frank Act to the point where it would be completely ineffective. Section 716 bans taxpayer bailouts of a broad range of derivatives dealing activities. Note that the Dodd-Frank Act does not in any way limit the swaps activities which banks or other financial institutions may engage in. It simply prohibits public support for such activities. The practical effect of this prohibition is to force banks to conduct large-scale derivatives dealing activities in a separate subsidiary which is backed by adequate private investment capital, and which is not eligible for Federal deposit insurance or liquidity support. If it goes into effect Section 716 will be a limitation on the ‘heads I win, tails you lose’ culture of Wall Street – the ability of the biggest Wall Street banks to benefit from the upside of derivatives risks while pushing losses on to the public.

The principle of separating bank derivatives activity from government support has been endorsed by numerous experts across the political spectrum. For example former FDIC Chair Sheila Bair has supported the changes made in Section 716 and stated that derivatives activity should not be supported with insured deposits<sup>2</sup>:

“Derivatives have many legitimate functions, but they can be high-risk and poorly understood because of their complexity by bank managers and even regulators, as we saw with the London Whale debacle - so keeping them outside of insured banks and making the market fund them is the way to go. This will increase market discipline and protect the FDIC.”

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<sup>1</sup> Americans for Financial Reform is an unprecedented coalition of more than 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

<sup>2</sup> Konczal, Michael, “[Interview with Sheila Bair](#)”, Washington Post Wonkblog, May 18, 2013.

Thomas Hoenig, the current Republican Vice-Chair of the FDIC, also believes swaps activities should be pushed out of the depository institution:<sup>3</sup>

“These activities [dealing in derivatives] are generally inconsistent with the funding subsidy afforded institutions backed by a public safety net. Such activities should be placed in a separate entity that does not have access to government backstops. These entities should be required to place their own funds at risk.”

The statutory Section 716 contained in the Dodd-Frank Act is already the result of a bipartisan compromise in the Conference Committee for the bill. This compromise added numerous exemptions to the original ‘Lincoln Amendment’ passed in the Senate, greatly reducing the scope of the ban on bailouts and addressing the objections of some regulators. Section 716 now exempts swaps referencing assets traditionally part of the business of banking - such as interest rate and foreign exchange swaps - from the ban on taxpayer bailouts. It also exempts bona fide hedging derivatives that are genuinely designed to reduce risks related to insured depository activities, allowing such hedging derivatives to remain within the depository institution. These and other exemptions permit banks to retain effectively all swaps that are genuinely banking-related, with no need for placement in a separate subsidiary.

H.R. 992 goes well beyond the already very broad exemptions in Dodd-Frank and effectively eliminates the Section 716 ban on government bailouts of derivatives dealing activities altogether. It would expand the list of instruments that could receive a public bailout to include almost all types of derivatives. If this bill were passed, commodity derivatives (e.g. energy swaps and agricultural swaps), equity derivatives, and non-cleared credit default swaps such as those that created the losses at AIG would once again be permitted to remain within insured depository institutions, at the heart of the public safety net. Insured depository institutions would be permitted to deal in customized credit default swaps that are not transacted through clearinghouses – one of the most difficult financial instruments to effectively risk manage. Almost no swaps activities would have to be ‘pushed out’ into separate subsidiaries. Proponents of H.R. 992 claim that their legislation maintains language banning taxpayer bailouts to swaps activities, but in fact this legislation expands the list of swaps activities *exempted* from the ban so much that the ban would effectively become meaningless.

H.R. 992 is supported by major Wall Street banks for one simple reason – because it is cheaper for them to engage in derivatives dealing when their activities receive a public subsidy through access to the taxpayer-supported safety net. The Dodd-Frank Act requires banks to find private risk capital to fund their derivatives dealing activities, instead of relying on public support. Derivatives operations have been at the center of numerous banking and financial scandals over the past two decades. Segregating some of these activities into separate subsidiaries, away from the portions of a financial institution that have access to public support, will help protect taxpayers from the threat of bailouts, restore private market discipline and benefit the entire financial system. If this bill is passed, however, these protections will be lost.

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<sup>3</sup> See Thomas Hoenig Letter to Blanche Lincoln, June 10, 2010, available at <http://www.docstoc.com/docs/42879716/Thomas-Hoenig-on-Blanche-Lincolns-derivatives-measure>

Supporters of this bill claim that if swaps are ‘pushed out’ into subsidiaries separated from depository institutions and access to Federal Reserve support, that they will somehow become less effectively regulated. This is inaccurate for many reasons. First, post-Dodd Frank swaps dealers are directly registered and regulated by the CFTC and SEC. Second, a subsidiary of a bank holding company is still regulated under consolidated supervision by the Federal Reserve. Third, and perhaps most importantly, private market oversight of swaps dealers will improve when dealers are removed from the public safety net. Counterparties will demand additional capital. Finally, this claim ignores the fact that co-mingling complex derivatives activities such as dealing in credit default swaps with the ordinary depository activities of the bank makes regulation of the other operations of the bank more difficult. All of the banks depository and lending activities are exposed to the potential for losses from the derivatives business.

Thank you for your consideration. For more information please contact AFR’s Policy Director, Marcus Stanley at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or 202-466-3672.

Sincerely,

Americans for Financial Reform

## **Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club

- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

*List of State and Local Partners*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET