

AFR Americans for Financial Reform

January 12, 2017

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 238, “The Commodity End User Relief Act”.¹ This legislation would have a severe negative impact on the Commodity Futures Trading Commission (CFTC) and its ability to police commodities and derivatives markets.

By freezing the CFTC’s funding at its current inadequate level for the next five years, this legislation exacerbates the agency’s most fundamental problem – a lack of resources to accomplish its mission. After the 2008 financial crisis, the CFTC became newly responsible for hundreds of trillions of dollars in previously unregulated swaps markets. Traditional commodity markets have also grown rapidly over the past decade. Due to these changes, the notional size of CFTC-regulated markets has increased by roughly fifteen times over the last decade, and the number of transactions in CFTC-regulated markets has grown from less than 2.5 billion to over 17 billion annually. But the agency’s funding lags far behind. Over the past decade it has grown only \$150 million (from \$100 million to \$250 million).

As the agency’s latest budget documents state:²

“The CFTC’s mission is to protect market participants from fraud, manipulation and abusive practices within the derivatives markets, and to protect the public and our economy from systemic risk. To do so, our agency requires increased funding...In the aftermath of the worst financial crisis since the Great Depression, which was devastating to America’s families, the Commission’s responsibilities were substantially increased.... But the CFTC’s budget has not kept pace with its expanded role and market growth.”

The CFTC’s 2017 funding request is \$330 million, which is a very small amount in the context of both the size and significance of the markets it supervises. Yet HR 238 authorizes only \$250 million annually for the CFTC over each of the next five years, a level more than 25% lower than the latest agency request.

Even as it fails to address the pressing problem of funding, HR 238 would also load down the CFTC with additional mandates that would drain resources and act as a roadblock to necessary oversight and enforcement. Section 202 of the bill would more than double the number of cost

¹ Americans for Financial Reform is an unprecedented coalition of more than 200 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.

² CFTC 2017 budget request available at

<http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/cftcbudget2017.pdf>

benefit analyses the agency must perform prior to taking any action. The CFTC already has a statutory requirement to consider the costs and benefits of its actions, and to evaluate these costs and benefits as applied to a number of significant considerations, including market efficiency, price discovery, and protection of the public.

However, Section 202 would massively expand this requirement. The section would enormously expand the number of different factors the CFTC must evaluate in any rulemaking, order, or guidance. It would also change the standard of evaluation from consideration of costs and benefits to a much more extensive and burdensome ‘reasoned determination’ of costs and benefits. Crucially, the section includes a particularly sweeping mandate that would require the agency to assess whether an action ‘maximizes net benefits’ compared to possible regulatory alternatives. This requirement alone, which seems to require comparison of any actual regulation to all possible theoretical alternatives, could be read to require dozens of additional agency analyses.

Some of this cost-benefit language does replicate cost-benefit instructions from the Office of Management and Budget that already applies to agencies within the executive branch, although not to independent financial regulatory agencies like the CFTC. However, a crucial difference is that since HR 238 would add this language in statute, each and every additional instruction regarding cost-benefit analysis could become grounds for a Wall Street lawsuit against a CFTC rule. These extensive new cost-benefit requirements amount to a playbook for industry interests to tie up regulations in endless litigation, delays, and red tape. With critical rulemakings such as position limits to control commodity price manipulation still incomplete almost five years after they were passed, the addition of new barriers to action would be dramatic movement in the wrong direction.

Section 312 of the legislation would also significantly weaken the authority of the CFTC to properly regulate derivatives transactions conducted through foreign subsidiaries of U.S. banks, even when such transactions have a direct and significant connection to the U.S. economy. We need only look at the example of J.P Morgan’s ‘London Whale’ transactions, or the London derivatives transactions of AIG Financial Products which resulted in the largest bailout in U.S. history, to see that derivatives transactions conducted through nominally overseas entities can have a profound impact on the U.S. economy. Over half of Wall Street derivatives transactions are typically booked in nominally foreign subsidiaries, and even more could be transacted in this way if there was an incentive to do so to avoid regulation.³

Section 312 would force the agency to perform burdensome ‘determinations’ before it could apply U.S. law to such foreign subsidiary transactions, even in cases where U.S. regulation is already in place and implemented. Its discretion in performing these assessments would be

³ Brush, Silla, “[Goldman Sachs Among Banks Fighting to Exempt Half of Swaps Books](#)”, Bloomberg News, January 30, 2012.

significantly limited by parameters set out in HR 238. For example, the agency would be forbidden from taking into the actual location of personnel doing swaps trading in determining whether a transaction was conducted inside or outside the United States for the purposes of applying U.S. law. It defies common sense to impose such extraordinary restrictions on the discretion of a regulatory agency charged with oversight of a market as complex and as important as the multi-trillion dollar derivatives market.

HR 238 also includes many additional changes. Some of them are reasonable. However, others could create significant statutory loopholes. For example, Section 307 of the legislation creates a significant new statutory exemption from CFTC authority for commodity options, an important type of derivative, so long as such options involve physical commodity delivery. In general, the ‘end user’ changes in this bill fail to recognize the very substantial administrative exemptions provided to end users by the CFTC. The CFTC has already exempted end users from numerous Dodd-Frank regulations in areas targeted by this bill. By acting through administrative processes the agency has maintained appropriate safeguards as well as the ability to act if market participants use exemptions to evade important risk controls.

But even before considering these issues, the major new restrictions on the agency created by the funding and cost-benefit provisions of this bill create overwhelming reasons to reject this legislation as currently written. So long as those provisions are a part of this legislation, supporting appropriate derivatives regulation requires opposing this bill.

We urge you to vote against HR 238 and preserve the CFTC’s capacity to properly regulate crucial futures and derivatives markets. For more information please contact AFR’s Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform