



**Americans for Financial Reform**  
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February 8, 2012

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 3283, the Swap Jurisdiction Certainty Act, which is the legislation being considered in subcommittee today. Americans for Financial Reform is an unprecedented coalition of over 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.

The financial crisis of 2008 cost the U.S. economy trillions of dollars and millions of jobs, and led to millions of families losing their homes. Globally, economists have estimated that the total cost of the financial crisis could exceed \$60 trillion. Lack of accountability on Wall Street was a created these enormous costs. According to recent polling data, almost 70 percent of Americans favor stronger regulations and oversight on big Wall Street banks and the financial services industry. A large majority also favor the recently passed Dodd-Frank Wall Street Reform Act.

In light of the clear need to address accountability in the financial sector, there has been little support for any attempt to repeal Dodd-Frank outright. So the big banks lobbying against increased oversight have turned to behind-the-scenes attempts to create complex loopholes in key parts of new regulations. This bill is a good example of a truly significant loophole buried in a seemingly technical piece of legislation.

HR 3283 would exempt foreign affiliates of U.S. banks and from all the major protections against derivatives risks contained in Title VII of the Dodd-Frank Act when dealing with non-U.S. persons. Because the definition of non-U.S. person would also include foreign affiliates of United States banks and insurance companies, large U.S. financial firms would also be able to avoid Title VII requirements simply by dealing through their foreign affiliates.

This is a major exemption. Major Wall Street banks have at minimum hundreds of subsidiaries in dozens of countries, and the largest can have thousands. As of 2007, for example, Citibank had over 2,400 different subsidiaries in 84 countries. A smaller institution, JP Morgan Chase, had over 800 subsidiaries in 36 countries.<sup>1</sup> Even more important, major banks manage the cash flow from these entities on a consolidated basis, so that money can flow at the touch of a computer

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<sup>1</sup> Cumming, Christine and Eisenbeis, Robert A., Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required? (July 1, 2010). FRB of New York Staff Report No. 457.

keyboard from any one entity to any other. Professor Richard Herring of the Wharton School has described the situation at Lehman Brothers<sup>2</sup>:

“But the fundamental problem was that LB [Lehman Brothers] was managed as an integrated entity with minimal regard for the legal entities that would need to be taken through the bankruptcy process. LBHI [Lehman Brothers Holdings, Incorporated] issued the vast majority of unsecured debt and invested the funds in most of its regulated and unregulated subsidiaries. This is a common approach to managing a global corporation, designed to facilitate control over global operations, while reducing funding, capital and tax costs. LBHI, in effect, served as banker for its affiliates, running a zero balance cash management system. LBHI lent to its operating subsidiaries at the beginning of each day and then swept the cash back to LBHI at the end of each day. The bankruptcy petition was filed before most of the subsidiaries had been funded on September 15th and so most of the cash was tied up in court proceedings in the US. Lehman also centralized its information technology so that data for different products and different subsidiaries were comingled.”

In other words, at Lehman Brothers, like most sophisticated global corporations, the total cash balances from all countries were moved in and out of the central corporate treasury on a daily basis. Thus, the total resources of the global operation were available to the parent company at all times. The last sentence points out that the organization was so integrated that the lines between the assets held by different subsidiaries were blurred in the company’s data management system.

For such integrated financial companies, losses in foreign subsidiaries can be disastrous to the parent company. Recall that the failure of Barings Bank after over 230 years of operation was due to actions by a single rogue derivatives trader in a Singapore subsidiary of the British bank. Recall also that AIG was exposed to massive derivatives losses through an affiliate located in London, AIG Financial Products. These were obviously extreme cases, but it is clear that large American banks organized on a global basis do routinely rely on cash flows from their foreign subsidiaries, and routinely fund losses at these subsidiaries. For reputational reasons it can be difficult for a parent company to simply refuse to honor debts incurred at a subsidiary, even if the parent has not explicitly guaranteed subsidiary debt (as often occurs).

This means that the stability of the U.S. financial system can certainly be affected by losses at foreign subsidiaries of U.S. banks. The blanket exemption from Title VII requirements would substantially increase the risk of such losses. It would include an exemption from any requirement for the derivatives dealer to hold margin against uncleared derivatives contracts. This means that foreign affiliates of a U.S. bank would be directly exposed to counterparty credit

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<sup>2</sup> Herring, Richard and Jacopo Carmassi, "The Corporate Structure of International Financial conglomerates: Complexity and Its Implications for Safety and Soundness," in *The Oxford handbook of Banking*, ed. by Allen Berger, 2010

risk from the failure of counterparties who were speculating in the markets. Capital requirements would also be eliminated for non-bank derivatives dealers and likely weakened for bank-affiliated dealers. In addition, this legislation would effectively repeal the Title VII prohibition on Federal government bailouts of derivatives dealers. Any such bailout could be channeled through a foreign affiliate and it would be received by the parent company.

In addition to the broad Title VII exemption, foreign derivatives subsidiaries of U.S. banks would also be permitted to substitute the capital requirements of their local (foreign) regulator instead of their U.S. regulator, so long as they were located in a jurisdiction that had signed the Basel accords. As the world now knows, European banks are systematically undercapitalized, and many European banking regulators are considered to be more lenient than U.S. regulators. Thus this provision could easily result in a weakening of effective capital standards for bank-affiliated derivatives dealers as well.

These radical steps are justified by the supposed need to preserve competitiveness for foreign derivatives subsidiaries of major U.S. banks in overseas derivatives markets. This is precisely the same argument that was used to prevent regulation of the over-the-counter derivatives markets a decade ago, when adoption of tough regulations could have helped prevent the catastrophic damage of the latest financial crisis. While there may be a connection between such competitiveness and the profitability of our largest Wall Street banks, the relationship to American jobs is less clear and may be negative. This legislation would create significant incentives for U.S. banks to channel derivatives business through foreign subsidiaries in order to evade regulation. It is likely that expansion of these operations would mostly create jobs overseas, and might even lead to the relocation of some U.S. jobs to foreign subsidiaries. It is certain it would increase the risk of yet another job-killing financial catastrophe.

Another unfortunate effect of the legislation would be to create incentives for a “race to the bottom” in financial regulatory standards among foreign countries, since countries with lower regulatory standards could attract derivatives dealers seeking lax regulation. This would undermine the process of global harmonization that is currently taking place in world derivatives markets. The U.S. has reached broad agreement with the G-20 on the need for capital, margin, and clearing protections in the world’s major derivatives markets. The U.S. is leading the way globally on implementation of these protections. The blanket exemption proposed in this legislation would actually undermine this process of harmonization by creating a powerful incentive for a country to set itself up as a haven from international regulation. Geographical exemptions from regulation fuel such “race to the bottom” outcomes and weaken incentives to coordinate.

Historically, the U.S. financial sector gained its international reputation due to our global leadership in creating stable and transparent markets. Indeed, it was over 150 years ago that the U.S. pioneered the derivatives clearinghouse. This was a major positive innovation in establishing robust and valuable marketplaces for commodities as well as key financial markets. The US economy will benefit from having transparent, sound and reliable capital markets, and global industry will participate in our capital markets to the extent that they are transparent, sound and reliable. Although permitting regulatory loopholes may create short-term profits, in the long run the greater threat to the

U.S. competitive edge is a repetition of the deregulation that led to the disastrous financial crisis of 2008. HR 3283 should be rejected.

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.*

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- 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
- 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
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions

- Housing Counseling Services
- Information Press
- 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
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- 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 Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- 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 Signers*

- 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



