AMERICANS FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

**Americans for Financial Reform**
**1629 K St NW, 10th Floor, Washington, DC, 20006**
**202.466.1885**

March 27, 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.[1] This legislation would effectively allow U.S. financial firms with an international presence to avoid Dodd-Frank regulation simply by dealing through their foreign affiliates. Furthermore, such foreign affiliates could be exempted from U.S. prudential protections such as capital requirements for their swaps business. This would create an overwhelming temptation to move swaps business overseas, indeed to the foreign jurisdictions where regulation was most lax compared to the U.S. In addition to seriously undermining the basic transparency and accountability requirements in the US, such a 'race to the bottom' would be a serious blow to the entire international effort to make derivatives markets safer.

The completely unregulated shadow markets in derivatives were at the center of the financial crisis of 2008, a crisis that cost the U.S. economy trillions of dollars and millions of jobs. In response to the clear need for derivatives oversight, Congress established a regulatory regime for derivatives in the Dodd-Frank Act. That regime relies on time-tested, well-established methods for organizing financial markets – competitive exchange trading and clearinghouses.

HR 3283 would undermine this regime by exempting any derivatives transaction between a U.S. swap dealer and a non-U.S. entity from all the major protections contained in Title VII of the Dodd-Frank Act. (The one exception is reporting requirements to regulators). Because the definition of non-U.S. entities would include many foreign affiliates, U.S. firms could easily avoid U.S. derivatives regulation by routing transactions through their overseas subsidiaries. This would not be difficult for a large financial institution to do. 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.[2] 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 keyboard from any one entity to any other. Professor Richard Herring of the Wharton School has described the situation at Lehmann Brothers[3]:

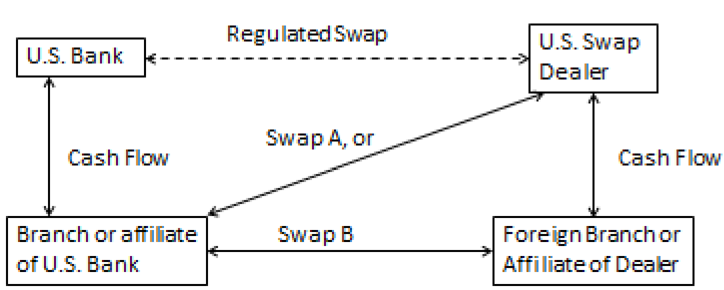
[1] Americans for Financial Reform is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.
[2] Cumming, Christine and Eisenbeis, Robert, Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required? (July 1, 2010). FRB of NY Staff Report No. 457.
[3] 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

"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, as at many 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 in Professor Herring's remarks 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.

The combination of multiple international subsidiaries and the ability to move cash easily between foreign subsidiaries and the parent company means that a broad exemption for international dealing opens up many options for evading Dodd-Frank derivatives requirements.

**HR 3283 Creates Multiple Options For Evading Regulated Swaps**




Under HR 3283, both Swap A and Swap B would be exempt from Dodd-Frank derivatives regulations

As shown in the diagram above, a U.S. financial firm could avoid regulation by having both parties deal through foreign affiliates and transferring the swap cash to the parent company. Or the U.S. dealer could simply contract directly with the foreign affiliate.[4]

Although swap dealers would be able to evade derivatives regulation using the exemptions in HR 3283, the U.S. economy could not evade the fallout from derivatives risks taken by internationalized companies. As discussed above, integrated financial companies rely on global cash flows, and 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, and that almost $40 billion of the U.S. taxpayer bailout of AIG was paid to foreign bank counterparties. 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 risk from the failure of counterparties who were speculating in the markets. This legislation would also 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. Since the Basel accords do not include capital requirements for non-bank derivatives dealers, HR 3283 could result in the elimination of basic capital and prudential standards for non-bank dealers. It would also likely result in a significant weakening of prudential standards for bank-affiliated derivatives dealers. As is now clear, European banks are systematically undercapitalized. Many European and other foreign banking regulators are considered to be more lenient than U.S. regulators.

All of 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

[4] A technical question in this bill is whether the foreign affiliate must itself be a bank or an insurance company, or the exemption for non-U.S. persons is broader. But even if the exemption only includes foreign banks it would appear simple for any U.S. firm to avoid regulation by purchasing a foreign bank and dealing through that bank.

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. Foreign subsidiaries would be covered only by local regulations. This means that countries with lower regulatory standards could attract derivatives dealers seeking lax regulation. This would undermine the process of global harmonization towards appropriate standards that is underway today. 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 must be rejected.

Thank you for your consideration. For more information please contact AFR's Policy Director, Marcus Stanley at 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.*

- 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