PUBLICCITIZEN Protecting Health, Safety and Democracy

June 16, 2014

Dear Representative,

Public Citizen opposes HR 4413, "The Customer Protection and End User Relief Act." Several provisions will severely undermine financial reform. These include:

- Adding unworkable cost-benefit analysis requirements that will only empower industry interests to bring litigation that will delay or negate important rules and do nothing to improve Commodity Futures Trading Commission (CFTC) regulations.
- Prohibiting the CFTC from supervising US swap operations overseas, which will invite riskier activity and raise the potential for more bailouts;
- Eliminating the ability of the CFTC to require certain safety rules for swaps.

New Cost-Benefit Requirements Don't Pass The Cost-Benefit Test

Wall Street has exploited the courts to delay, dilute and even overturn needed reform laws intended to return the financial industry to safer practices. Instead of making the CFTC more effective and efficient by bolstering their authority and improving their standing vis a vis the courts, HR 4413 actually makes the CFTC even more vulnerable to Wall Street lawsuits. The net effect will be weaker rules that will take the CFTC longer to finalize and will be more prone to reversal in court. In sum, this legislation will significantly damage, not improve, the CFTC's ability to adopt strong financial reforms that protect consumers and the public.

HR 4413 patently ignores the fact that the CFTC takes their cost-benefit requirements very seriously. In September 2010, the CFTC's General Counsel and Acting Chief Economist directed staff to produce cost-benefit analyses in proposed rulemakings and conceptual cost-benefit analyses in adopting releases. This is above and beyond existing CFTC requirements. In a follow-up memo, rule-making teams were directed to "incorporate the principles of Executive Order 13563" when writing rules. This order applied cost-benefit analysis requirements for departments overseen by the President. In May 2012, the CFTC, in an unprecedented move, entered into a memorandum of understanding with the Office of Information and Regulatory Affairs (OIRA) where OIRA provides "technical assistance" to CFTC staff during implementation of the Dodd-Frank Act, "particularly with respect" to cost-benefit analysis.[1]

[1] Memorandum of Understanding, OIRA, CFTC, (May 2012), available at: http://www.whitehouse.gov/sites/default/files/omb/inforeg/regpol/oira_cftc_mou_2012.pdf

Thus, the litany of additional cost-benefit analyses imposed by HR 4413 in no way improves the existing and extensive cost-benefit analysis practices at the CFTC. Rather the direct effect will be to convert the cost-benefit analyses the CFTC already conducts as a matter of best practice into numerous new legal grounds for Wall Street to challenge CFTC rules in court. Thus, the beneficiaries of these changes will be big Wall Street banks and their high-priced lawyers while the public pays the price of a far slower CFTC that must jump through even more hoops before putting common-sense Wall Street reforms in place.

Evading US Supervision

Some of the most dangerous financial practices by US firms leading to the financial crisis of 2008 were conducted overseas. AIG sold a form of bond insurance called credit default swaps from its London office, out of view of American supervisors. When AIG could not pay massive claims from bond defaults, taxpayers bailed out AIG's clients with $160 billion. More recently, JP Morgan's "Whale" transactions used US deposits for speculative derivatives trading in London, leading to a loss of more than $6 billion.

Section 359 nullifies the CFTC's rubric for overseeing American firms with foreign-based swaps business. Instead, it permits US firms to establish foreign-incorporated affiliates that would escape US supervision altogether. Already, certain US firms have begun to exploit a loophole in the CFTC's current rules to escape US supervision. This involves removing the guarantee of the US parent for the foreign-originated swap.[2]

Permitting foreign supervision is misguided because foreign supervisors won't have the same motivation as US supervisors to enforce prudential rules since a failure would fall on US taxpayers. In fact, foreign governments would be incentivized to relax oversight so as to attract more traders and the associated income tax revenue they would generate. The financial sector provides more than 11 percent of total tax revenue for the United Kingdom.[3] Not only does this legislation increase the chance for another US taxpayer bailout, it would sacrifice US tax revenue by incentivizing American firms to relocate their derivatives business abroad.

Safety margins prohibited

Unregulated swaps were at the heart of the financial crash, as derivatives dealers who failed to back up their swaps with adequate collateral spread financial contagion. This legislation removes some of the tools that the CFTC could use to promote safety. For example, HR 4413 prohibits the CFTC from requiring that end-users post margin collateral. The CFTC has declared that it would not require such margin, but it is important for the agency to retain this power if the market becomes unsafe in the future.

This is just one example of the flaws of this bill. There are many other sections that limit the ability of the CFTC to accomplish its mission of protecting investors and the public from misconduct in the $700 trillion swaps market. We believe Congress should be exploring ways to strengthen the agency, such as with self-funding and a larger budget, rather than working to undermine it.

We urge the House to reject HR 4413.

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[2] See letter of Rep. Maxine Waters, ranking member, House financial services committee, (June 13, 2014), available at: http://democrats.financialservices.house.gov/press/PRArticle.aspx?NewsID=1698

[3] "Total Tax Contributions of UK Financial Services," City of London Corp. (December 2013), available at: 7http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2013/total-tax-contribution-of-uk-financial-services-sixth-edition.pdf

For more information, please contact Public Citizen's Congress Watch Advocates: Amit Narang, Regulatory Policy Advocate at anarang@citizen.org; , or Bartlett Naylor, Financial Policy Advocate, at bnaylor@citizen.org.

Sincerely,

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