AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY * FAIRNESS * SECURITY

Americans for Financial Reform
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January 7, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 37, the "Promoting Job Creation and Reducing Small Business Burdens Act'".[1]

While this legislation is presented as simple 'technical corrections' to the Dodd-Frank Act and other areas of financial regulation, in fact it goes well beyond that. Some elements of the bill, such as Title V on swaps data indemnification, are reasonably classified as bipartisan technical corrections. But others would significantly delay and weaken implementation of core parts of the Dodd-Frank Act such as the Volcker Rule, and could dangerously limit regulatory authority to police financial markets. In light of the need to effectively regulate our financial markets in response to the problems revealed in the crisis of 2008, we urge you to reject this legislation.

It is also entirely inappropriate that this legislation is being considered under suspension of the rules. The issues raised by the substantive changes made in this bill deserve careful debate in the new Congress, and should not be rushed through the legislative process without full discussion and debate. .

Title I of the bill would forbid regulators from imposing requirements that margin or collateral be provided for derivatives transactions involving commercial companies. Both prudential banking regulators and market regulators have already proposed to exempt transactions with commercial end users from derivatives margin requirements, so this legislation is unnecessary. The legislation is also harmful in that it entirely eliminates statutory authority for the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to regulate margin and collateral at non-bank derivatives dealers serving commercial end users.

The oversight of margin and collateral for derivatives transactions is a basic regulatory safeguard. Even though regulators have not proposed to require any margin of commercial end users at this time, it is inappropriate to completely eliminate the ability of central derivatives market regulators to take action in this important area.

Title II of the bill would expand exemptions to derivatives clearing requirements to include affiliated financial entities of commercial companies (commercial companies themselves are already exempted from the clearing requirement).

[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. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

The requirement that standardized derivatives transactions be cleared through a central counterparty is a fundamental financial system safeguard established by the Dodd-Frank Act. While commercial entities using derivatives to hedge legitimate commercial risk are already exempted from clearing requirements, financial entities can only qualify if they are hedging risk on behalf of an affiliated commercial company and are acting as the agent of the commercial affiliate. This legislation would remove these limitations and leave in place only a requirement that the financial entity was somehow hedging or mitigating the risks of a commercial affiliate. As many purely financial trades can be interpreted to somehow 'mitigate the risks' of the broader corporate group, including commercial affiliates, this protection is vague and non-specific.

This seemingly technical change could have far-reaching implications. There are numerous major financial entities that have commercial affiliates and could claim that there was some relationship between their derivatives activities and hedging risks for some commercial affiliate. For example, the Senate Permanent Subcommittee on Investigations has recently documented that the major Wall Street banks often combine commodity production and trading activities, and that these "financial companies often traded in both the physical and financial markets at the same time, with respect to the same commodities, frequently using the same traders on the same trading desk."[2] The Permanent Subcommittee's report also documents the risks created by this combination of commercial and trading activities. This legislative change would significantly reduce the ability of the CFTC to police risk management for this kind of co-mingling of commercial and financial activities, both at major banks and at commercial companies like General Electric that have large financial subsidiaries such as GE Capital.

This legislation is also unnecessary as the CFTC has already provided broad exemptions in cases where they believe that financial entities are acting as treasury units and legitimately hedging commercial risks on behalf of commercial entities.[3]

Title IV of the bill would eliminate SEC broker-dealer registration requirements for merger and acquisition brokers. While a narrow version of this legislation could be sensible, this version lacks needed investor protections such as provisions to prevent bad actors from taking advantage of exemptions from registration to evade enforcement of securities laws.[4]

Furthermore, the SEC has already taken administrative action to reduce regulatory requirements in this area and exempt merger and acquisition brokers from broker-dealer registration in many cases. [5] But the statutory restrictions created by this legislation would tie the hands of the SEC in policing this complex area and addressing cases in which enforcement was needed to protect

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[2] United States Permanent Subcommittee on Investigations, "Wall Street Bank Involvement With Physical Commodities, Majority and Minority Staff Report", Permanent Subcommittee on Investigations, United States Senate, November 20, 2014.

[3]Commodity Futures Trading Commission, Division of Clearing And Risk, "No-Action Relief For Swaps Entered Into By Eligible Treasury Affiliates", CFTC No-Action Letter 13-22, June 14, 2013; Commodity Futures Trading Commission, Division of Clearing And Risk, "Further No-Action Relief For Swaps Entered Into By Eligible Treasury Affiliates", CFTC No-Action Letter 14-44, November 26, 2014.

[4] North American Securities Administrators Association, "NASAA Letter to Senators Manchin and Vitter Re S 1923", September 8, 2014

[5] Securities and Exchange Commission, "No-Action Letter Re M&A Brokers", January 31, 2014 [Revised February 4, 2014].

investors. For example, the definition of merger and acquisition broker here could encompass some private equity, and could therefore interfere with ongoing SEC investigations of potential abuses in the private equity area involving unregistered broker-dealer activities.[6]

Title VII of the bill would exempt over 60% of publicly traded companies from requirements to file machine-readable financial statements. By banning the SEC from requiring most companies in the market to file computer-readable financial data, this legislation would strike a serious blow against progress in bringing financial reporting into the 21st century. The legislation also directly contradicts recommendations from SEC staff and the SEC's Investor Advisory Committee which call on the agency to move to an open data disclosure system in order to benefit investors, issuers, and the public.[7]

Should Congress wish to address issues in the SEC's implementation of open data requirements, the answer is not to simply exempt the bulk of the market from any requirement to provide machine-readable data to investors. Instead, Congress should take steps that assist the SEC and the issuer community in moving data disclosure forward into the modern era of computerized, machine-readable information. Such steps could significantly improve financial sector transparency.

Title VIII of the bill would limit regulators' capacity to implement the Volcker Rule banning proprietary trading at banking institutions. This legislation would extend the deadline for bank divestment of Collateralized Loan Obligations (CLOs) until 2019. CLOs are complex securitizations generally used to sell leveraged loans, a class of assets that have been the subject of multiple recent warnings from regulators due to their risks.[8] The Volcker Rule restricts ownership of certain types of CLOs, because banks who own such securitizations can use them to replicate hedge fund type proprietary trading.

Extending the CLO divestment deadline to 2019 would permit banks two additional years in which they could continue to own a wide variety of securitizations that would permit them to perform hedge-fund like trading.[9] That is 9 years past the passage of the Volcker Rule's ban on this activity. This provision defines CLOs as any asset backed securitization composed 'primarily' of commercial loans, meaning that any securitization vehicle holding just half of its assets in business loans would qualify for this extension. This would cover a wide range of securitizations, including many that transacted in exotic securities.

Since the CLO market is dominated by a few of the nation's largest banks, this weakening of the Volcker Rule can be expected mainly to benefit large Wall Street banks seeking an end run around proprietary trading restrictions.

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[6] Morgenson, Gretchen, "Private Equity's Free Pass", New York Times, September 27, 2014.
[7] Securities and Exchange Commission, "21st Century Disclosure Initiative, Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System", January 2009; Securities and Exchange Commission Investor Advisory Committee, "Recommendations of the Investor as Owner Subcommittee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors", July 25, 2013.
[8] McGrane, Victoria, and Gilliam Tan, "Lenders Are Warned on Risk", Wall Street Journal, June 25, 2014; Cross, Tim, "Leveraged Loan Market Remains Hot as CLOs Offset Fund Outflows", Forbes Magazine, June 13, 2014.
[9] Regulators have already granted an extension of two additional years, through 2017, for banks to hold CLOs,

In sum, HR 37 includes numerous changes that could have significant negative impacts on regulators ability to police the financial markets so that they function safely and transparently. We therefore urge you to oppose this legislation.

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