Americans for Financial Reform
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202.466.1885

June 3, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 2289, "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 commodity and derivatives markets. The new restrictions it places on the CFTC would require additional years of bureaucratic red tape prior to agency action, would enable numerous industry lawsuits against the agency, and would create inappropriate statutory restrictions on the agency's ability to properly oversee markets crucial to the financial system.

At the same time, this legislation includes no provisions that address the CFTC's most fundamental problem – the lack of resources to accomplish its mission. Due to the agency's massive new responsibilities under the Dodd-Frank Act for hundreds of trillions of dollars in previously unregulated derivatives markets, as well as the growth of traditional commodity markets, the size of CFTC-regulated markets has increased roughly 15-fold over the last decade. But the agency's funding lags far behind. As CFTC chair Tim Massad recently stated:[2]

> "The CFTC does not have the resources to fulfill our new responsibilities as well as all the responsibilities it had – and still has – prior to the passage of Dodd Frank in a way that most Americans would expect. Our staff, for example, is no larger than it was when Dodd-Frank was enacted in 2010….Simply stated, without additional resources, our markets cannot be as well supervised; participants and their customers cannot be as well protected; market transparency and efficiency cannot be as fully achieved."

While the CFTC's funding is appropriated, the agency authorization process is an appropriate mechanism for introducing mechanisms that would supplement appropriations with some form of agency self-funding. Such self-funding mechanisms are used by all other financial regulatory agencies and have been endorsed for the CFTC by every administration going back to the Reagan Administration, including the Bush and Obama Administrations.

Instead of addressing the pressing problem of funding, HR 2289 would instead load down the CFTC with additional mandates that would drain resources and act as a roadblock to necessary oversight and enforcement. Section 202 of HR 2289 would more than double the number of cost benefit analyses the agency must perform prior to taking any action. The CFTC already has a

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

[2] Massad, Timothy, "Testimony Before The U.S. Senate Committee on Agriculture", May 14, 2015.

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. The section includes a particularly sweeping mandate that would require the agency to assess whether an action 'maximizes net benefits' compared to all possible regulatory alternatives. This requirement alone, which seems to require comparison of any actual regulation to a potentially vast number of theoretical alternatives, could be read to require dozens of additional agency analyses.

Some of this 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 HR 2289 would add this language in statute, meaning that 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 major new barriers to action would be dramatic movement in the wrong direction.

Section 314 of the legislation would also greatly weaken the authority of the CFTC to properly regulate derivatives transactions booked in 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 currently 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 314 would force the CFTC to perform burdensome 'determinations' in order to regulate foreign subsidiary transactions. Its discretion in performing these assessments would be limited in numerous ways by the legislation. To take just one example, the agency would be banned from considering the actual physical location of personnel doing swaps trading in determining whether a transaction was conducted inside the United States for the purposes of applying U.S.

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[3] Brush, Silla, "Goldman Sachs Among Banks Fighting to Exempt Half of Swaps Books", Bloomberg News, January 30, 2012.

law. It defies common sense to impose such extraordinary restrictions on the discretion of a regulatory agency charged with oversight of the multi-trillion dollar derivatives market.

HR 2289 also includes many additional changes. Some of them, such as amendments to indemnification requirements for swaps data repositories, are reasonable. However, others create significant statutory loopholes that could permit evasion of derivatives regulations by large banks. For example, Section 301 of the legislation permits large financial institutions affiliated with commercial entities to take advantage of exemptions from key Dodd-Frank risk controls that were intended to apply only to commercial end users. The nonpartisan Congressional Research Service has stated that the language included in Section 301 "could potentially allow large banks to trade swaps with other large banks and not be subject to the clearing or exchange trading requirements as long as one of the banks had a nonfinancial affiliate".[4]

Some of the other problematic parts of the bill expand the definition of 'commercial end user' to include financial entities (Section 306), create sweeping exemptions from CFTC oversight for broad classes of complex financial instruments (Section 309), weaken Commission authority to require swap dealers to raise equity capital to back up their trades (Section 311), permit marketing of complex institutional commodity pools to retail investors (Section 312), and weaken limits on commodity market speculation (Section 313). All of these sections appear significantly overbroad and could enable evasion of appropriate regulatory oversight.

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. In contrast, many of the provisions in HR 2289 would provide sweeping statutory exemptions that lack appropriate controls on risk and could easily become dangerous loopholes.

But even before considering these issues, the major new restrictions on the agency created by the cost-benefit and cross-border 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 2289 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

[4] See Congressional Research Service, "CRS In Focus: HR 37 Derivatives Provision May Create Broader Exemption", January 26, 2015