August 21, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Exemptive Order Regarding Compliance With Certain Swap Regulations (RIN 3038-AE05)

Dear Ms. Jurgens:

Better Markets Inc.[1] appreciates the opportunity to comment on the above-captioned exemptive order regarding compliance with certain swap regulations ("Release", "Exemptive Order," "Order") stemming from Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), issued by the Commodity Futures Trading Commission ("CFTC," "Commission").

INTRODUCTION

The development of derivatives markets has led to a situation in which transactions booked abroad can bring risk back home to the United States taxpayer. This was clearly illustrated during the financial crisis of 2008-9, when over-the-counter ("OTC") derivatives incubated and triggered a global financial meltdown. Recognizing this, Congress required the CFTC to apply the new derivatives regulations of the Dodd-Frank Act – designed to increase transparency and mitigate systemic risk – to offshore transactions in any case where such activities have a "direct and significant" impact on United States commerce.

On July 5, 2013, the CFTC passed final interpretive guidance on the cross-border application of Title VII derivatives regulations ("Final Guidance"). At the same time, the Commission passed an Exemptive Order to give market participants time to phase in their new compliance requirements. It was wholly appropriate that the CFTC did not give advance notice and comment for the Exemptive Order, as it was an urgent item. To pass the Final Guidance without an accompanying exemptive order would have forced industry participants to change their compliance procedures too fast, while to delay the Final

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

Guidance any further would have left the United States taxpayer at a heightened risk of having to fund another bailout – an unacceptable situation.

The Release states that the CFTC is seeking public comment because "the transition to the Guidance is complex and could apply in varied ways to different situations."[2] In other words, the Commission seeks comment on unforeseen loopholes or consequences that the Final Guidance and Exemptive Order might have generated.

Our comments focus on two issues: the timing of the phase-in under the Exemptive Order, and the substituted compliance determinations that are expected to occur by mid-December. First, it is crucial that no further delay be considered beyond that provided for in the Order, which is ample. Second, when it comes to substituted compliance, comparisons must be undertaken in a rigorous and detailed manner, with special attention paid to possible loopholes in foreign regulations and the enforcement record of the foreign regime under consideration.

DISCUSSION

Further Delay Beyond The Current Exemptive Order Is Neither Necessary Nor Warranted.

The CFTC has now been deliberating the cross-border application of Title VII derivatives regulation for over two years. The Commission has received input from industry, foreign regulators, and the public in the form of 322 filed comment letters and dozens of meetings. The Final Guidance is, in most substantive respects, a direct outgrowth of the initial Proposed Guidance from June 2012[3] and the further Proposed Guidance of December 2012.[4] Concurrent with the December guidance, the CFTC issued an exemptive order pushing back the effective date of the cross-border application of Title VII of the Dodd-Frank Act for yet another seven months, to July 12, 2013. That exemption has now been extended for a further seventy five days (and longer, for several key jurisdictions). Those affected by the guidance have had ample time to process the new compliance measures that will be required of them, and the additional exemption provides ample time for these measures to be fully implemented.

It is important to remember that the guidance itself does not, in fact, place any new burdens on market participants. It merely provides clarification so that industry participants can have greater certainty as to the compliance measures they ought to employ given their statutory requirement to comply with the Dodd-Frank Act when engaging in overseas derivatives transactions with a direct and significant impact on the United States. The guidance, therefore, actually **lessens** the burden on the industry, by providing certainty in a situation where, absent such guidance, participants would have to depend on legal advice to interpret the language of the statute, a scenario which would tend to encourage erring on the side of caution.

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2 Release at 43786.

3 http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2012-16496.

4 http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2012-31734.

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The trade-off at stake is clear: giving industry participants who have already had ample time to adapt to a further extension that they do not need (but can be expected to ask for in perpetuity), or protecting the U.S. taxpayer as the law directs the CFTC to do. In this context, any further exemption beyond the current Exemptive Order would be wholly unjustified.

The Forthcoming Substituted Compliance Determinations Must Be Thorough, Rigorous, and Detailed; They Must Not Open Loopholes Due To Hasty Decisions

The CFTC has recently received requests for Substituted Compliance determinations from parties located in six jurisdictions: Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland.[5] Consequently, the Exemptive Order provides entities operating within these jurisdictions a safe harbor from various regulatory requirements until the earlier of December 21, 2013 or 30 days following the issuing of a Substituted Compliance determination.[6]

The Final Guidance makes it clear that "[a]ny comparability analysis will be based on a comparison of specific foreign requirements against specific related CEA provisions and Commission regulations in 13 categories of regulatory obligations"[7] These categories are:

Entity Level:

1. Capital Adequacy
2. Chief Compliance Officer
3. Risk Management
4. Swap Data Recordkeeping
5. SDR Reporting

Transaction-Level:

1. Required Clearing And Swap Processing
2. Margining And Segregation For Uncleared Swaps
3. Trade Execution
4. Swap Trading Relationship Documentation
5. Portfolio Reconciliation And Compression
6. Real- Time Public Reporting
7. Trade Confirmation
8. Daily Trading Records

All of these categories are crucial for a robust derivatives regulatory regime. We discuss them in turn below.

5 Release at 43786.
6 Release at 43790.
7 Final Guidance at 45344.

Entity Level Requirements

1. Capital Adequacy

The Basel III standards ensure broad consistency in capital requirements for banks internationally. However, there may be important differences in implementation. Moreover, the treatment of derivatives is not wholly determined by the Basel III standards, and the standards do not apply at all to non-banking entities.

Consequently, it is extremely important that the CFTC examine the specific treatment of capital as it pertains to derivatives for both banking and non-banking entities in foreign jurisdictions. Capital held against derivatives exposures is a critical line of defense between risky swaps activities and the United States taxpayer. Recognizing this, the CFTC rule on margin requirements for nonbank entities ensures that Swap Dealers ("SDs") and Major Swap Participants ("MSPs") "would be required to maintain tangible net equity equal to $20 million, **plus additional amounts for market risk and over-the-counter derivatives credit risk.**"[8] Substituted compliance cannot be permissibly granted where this latter condition is not present.

Had banks and other institutions been better capitalized in 2008, the impact of the last crisis would have been significantly mitigated and, if they were properly capitalized, much of the crisis itself – and most of the bailouts (which were de facto after the fact capital contributions) -- could have been avoided. Conversely, if the CFTC were to grant substituted compliance for capital adequacy on the basis of broad capital standards without specifically considering the standards relating to derivatives, it might inadvertently approve a scenario in which derivatives risk created overseas comes back to cost the United States.

2. Chief Compliance Officer

The Chief Compliance Officer plays a pivotal role in ensuring that overburdened regulators can rely upon good faith compliance among the majority of market participants. However, the incentive structures within large financial firms are such that derivatives traders and executives are likely to push and sometimes exceed the boundaries of acceptable behavior in pursuit of profit, since the rewards from doing so (if not caught) can be enormous on an individual and firm-wide level.

To fulfill the crucial counterbalancing role required of a CCO, whoever is tasked with that job must be truly independent. The decisions to designate or terminate a CCO (or to materially change the CCO's position or responsibilities) should be the sole responsibility of the independent members of the board of directors (or Audit Committee)[9] acting by majority vote, and not the responsibility of any executive officer.

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8 http://cftc.gov/ucm/groups/public/@newsroom/documents/file/cr_factsheet.pdf (emphasis added).

9 Given their responsibilities and expertise, we believe that it would be best for the CCO to report to the audit committee of the board of directors, unless the entity does not have an audit committee, in which case the CCO should report to the independent members of the board of directors. Therefore, whenever we refer to "independent directors" in this letter, it means the audit committee for any entity having an audit committee.

While day-to-day reporting responsibility of a CCO will inevitably be to an executive officer, the CCO must also have a direct reporting line to the independent directors and the CCO should meet with and report to the independent directors no less than once a quarter. Compensation of a CCO should be the sole responsibility of the independent members of the board of directors, and not the responsibility of a senior officer. A CCO's office should be located remotely from a trading floor. And finally, discussions between a CCO and traders or executives with oversight responsibility over traders involving trading practices and strategies and compliance should be recorded by the CCO and retained in his or her records.[10] Absent the presence of all these criteria in a foreign jurisdiction, independence of the CCO would be illusory. Thus, substituted compliance should not be granted with respect to Chief Compliance Officers unless all these conditions are met.

3. Risk Management

The entire purpose of the cross-border derivatives regime is to ensure that excessive risks accumulated abroad cannot come back to damage the United States financial system and economy as well as the U.S. taxpayer and treasury. Therefore, foreign risk management requirements take on an added importance.

Under the language of the Dodd-Frank Act, covered swap entities must "establish risk management procedures adequate for managing the day-to-day business of the swap dealer or major swap participant"[11] Where equivalent language does not exist overseas, the CFTC should drill down into the specific requirements placed on MSPs and SDs to see if they are otherwise covered. Conversely, even where equivalent language exists at a statutory level, the CFTC must be diligent in verifying that the technical standards implementing that language are genuinely comparable and comprehensive.

4. Swap Data Recordkeeping

The CFTC's rules relating to swap data recordkeeping are appropriately comprehensive and thorough. The framers of the Dodd-Frank Act clearly intended it this way, recognizing that the ability to fully reconstruct trades and construct an audit trail relating to possible violation of business conduct standards in the lead-up to a trade were essential to a robust and efficient marketplace.

Since enforcement of sanctions against misconduct already faces hurdles when the activities in question take place overseas, it is doubly important that the CFTC ensure the records kept in such situations are at least as strong as those in the U.S. Formats may differ, but the key principle that there must be sufficient information to reconstruct the events leading up to any given swaps transaction must not.

[10] *See* Better Markets letter "Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant" (Jan. 18, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27213&SearchText=.

[11] http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/bcs_qas_final.pdf.

5. Swap Data Repository Reporting

Swap Data Repositories are the Commission's primary means to monitor the swaps markets in real time. In the absence of robust memoranda of understanding ("MOUs") with the relevant foreign regulators that provide the CFTC access to **all** relevant data **in real time**, Substituted Compliance must **never** be granted. The stakes are simply too high to allow a large blind spot in the CFTC's view of the marketplace when U.S. Persons and their affiliates as well as huge and interconnected foreign SDs and MSPs are directly involved. These are precisely the areas where the "direct and significant" test is clearly met, and where the risk can most clearly build up. Thus, to fulfill its Congressional mandate, the CFTC must not settle for anything less than equally comprehensive and timely access to swap transaction data in these cases.

Transaction Level Requirements

1. Required Clearing and Swap Processing

The joint agreement between the CFTC and European regulators makes it clear that, with respect to clearing mandates, coverage will be additive rather than disjunctive. That is, all swaps required to be cleared in the United States will also be required to be cleared when covered entities book them overseas. In addition, swaps that might not be required to clear in the United States will have to be cleared when booked overseas if those swaps are part of the clearing mandate of the foreign jurisdiction in question.[12]

This is clearly the appropriate approach, and the CFTC makes it clear in the Final Guidance that it will be put into practice. The Commission is to be commended on its prudent approach.

2. Margining and Segregation for Uncleared Swaps

The Bank for International Settlements and the International Organization of Securities Commissions ("BIS/IOSCO") have presented reasonable guidelines for margining and segregation for uncleared swaps.[13] However, there is one crucial regard in which the BIS/IOSCO proposals are far too weak. According to the CFTC's proposals, initial margin sufficient to cover 99 percent of 10 day fluctuations in price must be assessed on all uncleared swaps.[14] This is a prudent and necessary measure. However, under the BIS/IOSCO proposal, initial margin is subject to a "threshold" reduction, whereby counterparties may forego the first €50 million of initial margin.[15] This is a wholly unacceptable standard.

The rationale given by BIS/IOSCO is that such an approach would greatly reduce the amount of capital that would have to be put up to cover derivatives trades, which would free up that capital for other economic purposes. However, initial margin is an essential

12 http://www.cftc.gov/PressRoom/PressReleases/pr5905-10.
13 http://www.bis.org/publ/bcbs226.pdf and http://www.bis.org/publ/bcbs242.pdf.
14 http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/um_factsheet.pdf.
15 http://www.bis.org/press/p130215a.htm.

component of derivatives risk management.[16] "Freeing" that capital really means diverting it from its appropriate use, and will lead to excessive risk taking with inadequate capital to support it. Variation margin can cover small daily fluctuations in contract value, but initial margin provides the only buffer against sudden swings in price.

In stressed situations, it is specifically the initial margin, **not** the variation margin that prevents a crisis from occurring, since the variation margin will only cover the fluctuations that have already occurred, **not** the sudden fluctuations that occur in a short period of time during a stressed market. Thus, deployment of capital in the form of initial margin is not redundant – it is essential to proper risk management.

For this reason, the CFTC must not grant Substituted Compliance in jurisdictions where initial margin is not **fully** assessed. A threshold approach is systemically risky and insufficiently robust to protect the U.S. taxpayer.

3. Trade Execution

Pro-forma, it is apparent that the Commission intends to make use of the "exempt DCO" designation when it comes to international swap execution facilities. This is a reasonable approach. However, it must be premised on several key tests.

First, any foreign swap execution facility that is granted "exempt DCO" status or otherwise deemed suitable for Substituted Compliance must run a central limit order book. Given the central role reserved for pre-trade transparency by the framers of Title VII of the Dodd-Frank Act, this must be considered an absolute minimum.

Second, a foreign facility that is deemed equivalent to a U.S. facility must have a minimum requirement of request-for-quote ("RFQ") to 5. A key goal of the Dodd-Frank Act was to break up the opaque and risky oligopoly of derivatives dealers. To preserve the stranglehold of these firms by enabling them to operate single dealer platforms or similar facilities overseas (such as the "systemic internalisers" countenanced by the MiFID II proposals) would be to undermine the clear intent of the U.S. law. This would undoubtedly have a direct and significant effect on U.S. commerce, and would therefore be a clear violation of the CFTC's statutory mandate.

Third, block trades have the potential to undermine a jurisdiction's entire derivatives execution regime. If block trade thresholds are set too low, a significant portion of the market remains opaque and therefore useless for price discovery and regulatory oversight. In making any Substituted Compliance determination (or similar decision via no action letters), the CFTC must closely consider whether the block trade thresholds in the relevant jurisdiction are either equal to or higher than those in the United States for similar contracts.

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[16] *See* Better Markets letters to BIS/IOSCO and CFTC on margin requirements for uncleared swaps, *available at* http://www.bettermarkets.com/sites/default/files/BIS-IOSCO-%20CL-%20Margin%20Requirements%20for%20Non-Centrally%20Cleared%20Derivatives-%203-15-13.pdf and http://www.bettermarkets.com/sites/default/files/CFTC-%20CL-%20Margin%20Requirements%20for%20Uncleared%20Swaps-%209-18-12.pdf.

4. Swap Trading Relationship Documentation

Proper swap trading relationship documentation is essential to fair and impartial valuation of swaps contracts. Absent such documentation, resolution of swaps and exchange of collateral can require lengthy and cumbersome arbitration. Particularly in a stressed market situation, this can be highly risky and inefficient. The CFTC must ensure that any foreign jurisdiction granted a Substituted Compliance determination with respect to swap trading relationship documentation has rules that facilitate timely, impartial valuation of all relevant swaps contracts.

5. Portfolio Reconciliation and Compression

Under the CFTC's final rules, swap dealers and major swap participants must regularly reconcile and compress their portfolios either by consulting with counterparties or by using a third party service. Valuation discrepancies of greater than 10 percent must be reconciled within 5 days. [17] This is a crucial step in creating safer derivatives markets. When Lehman and AIG collapsed, the crucial trigger was a wave of collateral calls in the midst of uncertainty surrounding valuations.[18] Regular reconciliation and compression ensures that variation margin payments are accurate and up to date, and significantly reduces the risk of a repeat of the confusion that triggered the Lehman and AIG collapses.

When evaluating Substituted Compliance determinations with respect to portfolio reconciliation, it is therefore essential that the Commission only approve a request in cases where the portfolio reconciliation and compression rules are such that variation margin is assessed in a timely and accurate fashion, and in which valuation discrepancies are resolved as quickly as possible.

6. Real-Time Public Reporting

Real-time reporting of swaps transactions is a cornerstone of Title VII, bringing futures-like post-trade transparency to what was previously a dark market rife with abuse. Real-time dissemination of prices ensures that market participants have the information necessary to negotiate proper pricing for their swaps. Not only does this reduce costs for end-users, it also leads to reliable price discovery, which helps a variety of economic actors to make informed decisions.

At the same time, the transparency from real-time reporting will almost certainly engender competition which will reduce the profits of large dealers' swap desks because they can no-longer easily overcharge customers uncompetitive prices . Should the dealers be allowed to avoid the real-time reporting requirement simply by booking their transactions overseas, it is clear that they will do so: the financial incentive will be irresistible.

Thus, the CFTC must not permit Substituted Compliance for reporting in any case where the foreign regime lacks a real time reporting requirement substantially identical to

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17 http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/bcs12_factsheet.pdf.

18 http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0701-Goldman-AIG-Collateral-Call-timeline.pdf.

that of the United States. Otherwise, the transparency of U.S. swaps markets, and the economic benefit this provides to the country, will be completely undermined. This would be a direct and significant detriment to U.S. commerce. As such, it would violate the Commission's statutory duty.

7. Trade Confirmation

The CFTC's trade confirmation procedures include an obligation to "furnish to, or receive from, [a] prospective counterparty, a draft acknowledgement specifying the terms of the swap transaction (other than pricing and the terms to be definitively agreed to at execution), prior to execution."[19]

This pre-trade "term-sheet" approach is standard practice in many forms of contractual interaction, yet in the unregulated, non-transparent world of OTC derivatives dominated by just a few large dealer firms, it has largely been absent. Requiring this perfectly reasonably business practice as a safeguard against inefficient misunderstandings – or, worse, intentional exploitation – was an essential part of the CFTC's final rule. Any Substituted Compliance determination with respect to trade confirmations must specifically look for equivalence in this pre-trade requirement.

8. Daily Trading Records

The CFTC's final rules on daily trading records requires swap dealers and major swap participants to ensure:

> (1) that they preserve all information necessary to conduct a comprehensive and accurate trade reconstruction for each swap, and
>
> (2) that they maintain each transaction record in a form identifiable and searchable by transaction and counterparty.[20]

In making a Substituted Compliance determination, it is critical that the Commission find comparability on **both** these grounds, not just one. The ability to reconstruct trades is essential to uncovering violations of business conduct standards, market manipulation, and other transgressions. Searchability by transaction and counterparty is crucial in stressed situations to ensure an orderly unwind and to avoid a repeat of the chaos surrounding the Lehman Brothers failure.

Economic Analysis

The statutory standard.

Section 15(a) of the CEA sets forth the CFTC's statutory requirement to "consider" the costs and benefits, as they relate to certain public interest factors, of each discretionary action it takes under its statutory authority. 7 U.S.C. § 19(a). Specifically Section 15(a) directs the agency, when promulgating a rule or order (other than an "emergency

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19 http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cprpcr_factsheet.pdf.
20 http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/bcs_qas_final.pdf.

action"),[21] to "consider the costs and benefits of the action of the Commission" and to evaluate those costs and benefits "in light of"—

(A) considerations of protection of market participants and the public;

(B) considerations of the efficiency, competitiveness, and financial integrity of futures markets;

(C) considerations of price discovery;

(D) considerations of sound risk management practices; and

(E) other public interest considerations.

The persistent and unfounded criticisms from industry regarding economic analysis.

Even when the CFTC has clearly fulfilled its duty to consider the economic impact of its rules, representatives from industry have challenged proposed rules claiming – without merit – that the CFTC failed to appropriately conduct what the industry calls "cost-benefit analysis."

These attacks rest on a series of fundamentally flawed claims. For example, in challenging rules promulgated by the CFTC, the industry has:

(1) greatly exaggerated the actual duty imposed on the CFTC by its governing statute, Section 15(a) of the CEA, in effect seeking to transform that limited duty into an "industry cost-only analysis;"

(2) entirely disregarded the paramount statutorily required role of the public interest in the rulemaking process; and

(3) indefensibly ignored the enormous cost of the financial crisis and the larger collective benefit of all rules designed to help prevent a recurrence of that crisis or something far worse.[22]

Core principles that must apply to the CFTC's consideration of costs and benefits.

When analyzing these attempts to undermine financial reform on what industry claims to be cost-benefit grounds, it is vitally important to bear in mind several core principles that accurately define the true nature and scope of the obligation that the CFTC has when considering the economic impact of its rules.

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[21] It is unclear whether the Commission views the Exemptive Order as an "emergency action" and therefore exempt from any statutory economic analysis. However, given the nature of the Order and its necessity to prevent firms from having to comply with all of Title VII immediately upon release of the Final Guidance, it appears that this would qualify as an emergency action. Nonetheless, Better Markets comments on this aspect of the Order in the event the Commission finds these comments useful.

[22] *See* BETTER MARKETS, THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION (Sept. 15, 2012), *available at* http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis.pdf.

1. *Under the CEA, the CFTC has no statutory duty to conduct cost-benefit analysis; in fact, its far more narrow obligation is simply to consider certain factors related to the public interest.*

Section 15(a) of the CEA imposes a limited obligation on the CFTC simply to "consider" the costs and benefits of its rules in light of five specified public interest factors. [23] It contains no language requiring a cost-benefit analysis and there is no basis for imposing any such requirement (and certainly none for an industry cost-only analysis, which is what the industry is really seeking). Indeed, the Court of Appeals for the District of Columbia has recently assessed the CFTC's economic analysis duty under Section 15(a) and confirmed that "[w]here Congress has required 'rigorous, quantitative economic analysis,' it has made that requirement clear in the agency's statute, but it imposed no such requirement here." Inv. Co. Inst. v. CFTC, No. 1:12-cv-00612, at 15 (D.C. Cir. June 25, 2013) (citing American Financial Services Ass'n v. FTC, 767 F.2d 957, 986 (D.C. Cir. 1985)); cf., e.g., 2 U.S.C. § 1532(a).

Moreover, Congress's careful choice of words in Section 15(a) and the case law construing similar provisions, make clear that the CFTC has broad discretion in discharging its duty. The Supreme Court has long recognized that when statutorily mandated considerations are not "mechanical or self-defining standards," they "imply wide areas of judgment and therefore of discretion" as an agency fulfills its statutory duty.[24]

In fact, the CFTC has no statutory or other obligation to quantify costs or benefits,[25] weigh them against each other,[26] or find that a rule will confer a net benefit before

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[23] Better Markets has set forth a comprehensive analysis regarding the scope of Section 15(a) in the *amicus curiae* brief it filed in support of the CFTC in *ISDA v. CFTC*, Civil Action No. 11-cv-2146 (RLW) ("*Amicus* Brief") (*available at* http://bettermarkets.com/sites/default/files/Corrected%20Brief%20of%20Better%20Markets%20as%20Amicus%20Curiae%20in%20Support%20of%20Defendant%20CFTC%20Apr.%2030,%202012.pdf). In that case, representatives of industry challenged, *inter alia*, the CFTC's consideration of costs and benefits in connection with the position limits rule. *See also* Better Markets *amicus* Brief filed in another case challenging a different rule, *available at* http://bettermarkets.com/sites/default/files/ICI%20v.%20CFTC%20-%20Amicus%20Brief%20of%20Better%20Markets%20June%2025,%202012.pdf. In addition, Better Markets has written to the Office of Management and Budget ("OMB") opposing CFTC Commissioner Scott O'Malia's request that OMB review the cost-benefit analysis performed by the CFTC in connection with several recently finalized rules. Letter from Better Markets to Jeffrey Zients, Acting Director of OMB (Feb. 29, 2012) ("Letter to OMB"), *available at* http://bettermarkets.com/sites/default/files/O'Malia%20CBA%20letter%20to%20OMB.pdf. In the Letter to OMB, Better Markets makes clear that various executive orders and OMB guidelines requiring cost-benefit analysis are inapplicable to the CFTC's rulemaking. Both *amicus* Briefs and the OMB Letter are incorporated by reference as if fully set forth herein.

[24] *Sec'y of Agric. v. Cent. Roig Ref. Co.*, 338 U.S. 604, 611 (1950).

[25] *Cf.* 42 U.S.C. § 300g-1(b)(3) (imposing a duty on the Environmental Protection Agency to use analysis of specific factors including the "[q]uantifiable and nonquantifiable health risk reduction benefits," the "[q]uantifiable and nonquantifiable costs," and "[t]he incremental costs and benefits associated with each alternative."). Courts have repeatedly held that an agency need not quantify the costs and benefits of a rule when a statute does not require it. *See, e.g., FMC Corp. v. Train*, 539 F.2d 973, 978-979 (4th Cir. 1976) (finding that 33 U.S.C. §§ 1314(b)(1)(B), (b)(2)(B) and § 1316 do not require quantification of the benefits in monetary terms). In fact, the D.C. Circuit has explicitly recognized that an agency's "predictions or conclusions" do not necessarily need to be "based on a rigorous, quantitative economic analysis." *Am. Fin. Services Ass'n. v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985); *see also Pennsylvania Funeral*

promulgating it. The rationale for this flexible obligation in the law is clear: requiring the CFTC to conduct a resource intensive, time consuming, and inevitably imprecise cost-benefit analysis as a precondition to rulemaking would significantly impair the agency's ability to implement Congress's regulatory objectives. The industry's desire to have its costs prioritized over all other costs (what they falsely refer to as "cost-benefit analysis") does not change the law, the reasoned basis for the law, or the underlying policy.

2. *The CFTC must be guided by the public interest as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.*

The five factors that the CFTC must consider as specified in Section 15(a) reflect Congress's primary concern with the need for regulations that serve the public interest and accomplish the agency's mission, not with a need to spare industry the costs of regulation. Without exception, each factor relates to a public benefit that arises from a robustly regulated marketplace, including preventing abuse, promoting competition, enhancing transparency, and limiting systemic risk.[27]

Tellingly, none of the factors listed in the statute mentions any industry-focused concerns, such as compliance costs or the feasibility of conforming to rule requirements.[28] Removing any doubt, the fifth and final factor in Section 15(a) requires the CFTC to consider generally "any **other public interest** considerations."[29]

3. *The CFTC need not consider the costs and benefits associated with mandatory rulemakings.*

It is also clear from the statute that the CFTC's obligation to consider costs and benefits applies only to the discretionary component of rulemaking. Not only is it unnecessary under the statute for the CFTC to consider the costs and benefits of actions mandated by Congress, it would also be fruitless for the agency to do so, since the agency has no authority to second-guess, ignore, or countermand the directives of Congress on cost-benefit or any other grounds.

Indeed, by mandating a rulemaking, Congress necessarily has already weighed the costs and benefits and the agency's role is simply to implement Congress's directive. To construe a statute otherwise would make it impossible for Congress to mandate a

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Directors Ass'n v. FTC, 41 F.3d 81, 91 (3d Cir. 1994) (recognizing that "much of a cost-benefit analysis requires predictions and speculation, in any context," and holding that the "absence of quantitative data is not fatal").

26 Courts distinguish statutes which include language of comparison, requiring a cost-benefit analysis, and statutes which do not. *See Am. Textile Mfrs. Inst. v. Donovan*, 452 U.S. 490, 512 n.30 (1981); *Reynolds Metal Co. v. EPA*, 760 F.2d 549, 565 (4th Cir. 1985); *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1045 (D.C. Cir. 1978).

27 7 U.S.C. § 19(a)(2).

28 *Cf.* 42 U.S.C. § 300g-1(b)(3)(C) (requiring analysis of certain costs of safe drinking water regulations including costs that "are likely to occur solely as a result of compliance with the maximum contaminant level, including monitoring, treatment, and other costs"); 42 U.S.C. § 6295(d) (1976 ed., Supp. II) (requiring a weighing of the economic impact on manufacturers and the savings in operating costs as "compared to any increase in the price of, or in the initial charges for, or maintenance expenses of, the covered products which are likely to result").

29 7 U.S.C. § 19(a)(2)(E) (emphasis added).

rulemaking because all such rules would nonetheless be subject to some form of economic or cost-benefit analysis by an agency and then, almost assuredly, by a court. That would violate the constitutional principles of separation of powers, subordinating Congress's legal powers to both the agencies, which are the very creatures created by Congress to carry out its directives, and the courts.

4. *For any rule promulgated in accordance with and in furtherance of the Dodd-Frank Act, the ultimate "public interest consideration" is implementing the reforms that Congress passed to provide for a safer and sounder financial system and to prevent another financial crisis.*

The statutory authority for the Exemptive Order is derived from the Dodd-Frank Act. The CFTC must therefore consider the costs and benefits of the Exemptive Order in light of the goals of that statute, giving proper weight to Congress's overriding objective. That objective is to institute a comprehensive set of reforms, including a regime for regulating swaps, to prevent another financial collapse and economic crisis, including trillions of dollars in financial losses and incalculable human suffering.

The dollar cost alone of the financial collapse and still-unfolding economic crisis is conservatively estimated to be in the trillions. A study by Better Markets estimates that those costs will exceed $12.8 trillion.[30] In addition, the Government Accountability Office has just issued the results of a study on the costs of the crisis, finding that "the present value of cumulative output losses [from the crisis] could exceed $13 trillion."[31] Therefore, as the CFTC assesses the costs and benefits of proposed rules under Section 15(a), it must continue to consider, above all, the benefits of the entire collection of reforms embodied in the Dodd-Frank Act, of which any specific rule is but a single, integral part.

5. *Congress's resolve to prevent another massively costly financial crisis clearly overrides any industry-claimed cost concerns under the Dodd-Frank Act.*

Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis. Those costs include the elimination of extremely profitable lines of business as well as significant and ongoing compliance costs. A leading example is the establishment of the new, comprehensive regulatory regime for swaps. It will require the financial industry to incur significant costs arising from new personnel and technology, ongoing compliance, margin and collateral, and reduced revenues and profits.

However, the financial reform law and the rules implementing it do not, in fact, add any incremental costs (or, if they do, those costs are *de minimis*). Rather, they reallocate

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30 *See* BETTER MARKETS, THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION (Sept. 15, 2012), *available at* http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis.pdf.

31 U.S. GOVERNMENT ACCOUNTABILITY OFFICE, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT, GAO-13-180, at 17 (Jan. 2013) (released Feb. 14, 2013), *available at* http://gao.gov/assets/660/651322.pdf.

failure and bailouts. As a result, the public and society are spared the massive costs of responding to economic crises after the fact.[32]

Congress fully understood this. It knew that re-regulation would impose costs on the industry, in some cases totaling billions of dollars. The Dodd-Frank Act reflects Congress's unflinching determination to shift the costs of de-regulation and non-regulation of the financial industry back to the industry from a society that has paid and continues to pay the bill for industry's unregulated excesses. In substance, Congress conducted its own cost-benefit analysis and concluded that the enormous collective benefits of the law far exceeded the costs and lost profits that industry would have to absorb.[33]

Against the backdrop of the worst financial and economic crises since the Great Depression, it is inconceivable that Congress would enact sweeping reforms and then allow the implementation of those reforms to hinge on the outcome of a biased cost-benefit analysis that ignored the overriding purpose of the new regulatory framework—and that gave controlling weight to cost concerns from the very industry that precipitated the crisis and inflicted trillions of dollars in financial damage and human suffering across the country.

Indeed, had Congress wanted the financial regulatory agencies to conduct cost-benefit analysis prior to promulgating the rules under the Dodd-Frank Act, it would have clearly said so. Congress passed the Dodd-Frank Act fully aware of the specific economic analysis provisions in the federal agencies' governing statutes—like Section 15 of the CEA—and fully aware of how to impose a cost-benefit analysis requirement. Yet, it made no changes to those provisions, thereby affirming congressional intent that those specific provisions should control as they were originally written and intended.

In short, the following analytical framework must guide any consideration of the economic impact of rules implementing the Dodd-Frank Act, or any rules that are promulgated within the broader Dodd-Frank Act context:

- Congress's ultimate objective in the Dodd-Frank Act was to prevent another crisis and the massive costs it would inflict to our financial system, taxpayers, investors, economy, and country;
- The rule is an integral component of the overall body of reforms that Congress envisaged to achieve this objective; and
- The costs of compliance and reduced profits that industry may have to absorb by virtue of the rule, as well as the entire Dodd-Frank Act, were considered by Congress in passing the law and determined to pale in comparison with the benefits of preventing another crisis—a benefit that can be valued at over $12.8 trillion.

[32] *See* BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC, at 39-44 (July 30, 2012), *available at* http://bettermarkets.com/sites/default/files/CBA%20Report.pdf.

[33] *Id.* at 43.

<u>The Application of Section 15(a) in the Release.</u>

The Release shows that the CFTC has considered the economic impact of the Exemptive Order. It shows clearly that the CFTC complied with the statutory standard, considering costs and benefits for each public interest factor that is relevant.

The section begins with an acknowledgment that the consideration need only be conducted for the discretionary component of the CFTC's rulemaking.[34] This confirms that where Congress mandates a rule, the agency is not obligated to consider those mandatory costs and benefits.

Then the CFTC appropriately identifies the "five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations." And, it appropriately ties those areas of concern directly to the Exemptive Order where relevant. The CFTC clearly satisfied whatever duty it had under Section 15(a) of the CEA to consider the costs and benefits of the Exemptive Order.

CONCLUSION

We hope these comments are helpful as the Commission implements the Final Guidance and makes substituted compliance determinations.

Sincerely,

Dennis M. Kelleher
President & CEO

David Frenk
Research Director

Better Markets, Inc.
Suite 1080
1825 K Street, N.W.
Washington, D.C. 20006
(202) 618-6464

dkelleher@bettermarkets.com
dfrenk@bettermarkets.com

www.bettermarkets.com

[34] Release at 43,791.