June 24, 2013

BY HAND DELIVERY

The Honorable Mark Wetjen
Commissioner
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Commissioner Wetjen,

The regulation of cross border derivatives activities currently hangs in the balance, with the CFTC reportedly deadlocked at 2-2 and with you largely undecided. Therefore, I thought it might be helpful to summarize our responses to the key issues you have raised and which we discussed at our recent meeting on this extraordinarily important issue.

As you know, our view is that, after 2 ½ years of consideration, there are simply no valid reasons for the CFTC to delay yet again finalizing its cross border guidance by July 12, 2013 and making it as strong as possible to protect the American people from having to bail out the global financial system again.

SUMMARY OF RESPONSES

1. The recently proposed SEC rule on cross border is—

    a. inapplicable to the CFTC's statutory mandate to regulate cross border transactions with a "direct and significant" connection to the United States;

    b. very weak regarding the issue it does cover, i.e., anti-evasion; and

    c. grossly deficient in its approach to "substituted compliance" and will almost certainly ignite a global race to the regulatory bottom, exposing U.S. taxpayers to unacceptably high risks of having to bail out Wall Street again.

2. As a recent study by the CFTC demonstrated, there are **no** current conflicts between the CFTC cross border guidance and any international laws, rules or regulations;

3. It will take years for foreign governments and regulators to catch up to the U.S. on comprehensive derivatives regulation—if in fact they ever do adopt and implement

truly comparable regulations—and waiting for them before protecting U.S. taxpayers and the treasury is unjustifiable;

4. Substituted compliance, if it is used at all, must be comparable in form, substance, enforcement and over time on a rule-by-rule basis and not an excuse to outsource the protection of the American people,

    - especially to foreign regulators who have a record of repeatedly failing to protect their own depositors, taxpayers and treasuries; and

5. Cross border derivatives blow-ups and the financial crisis have already cost the U.S. trillions of dollars and an enormous amount of suffering, and it must be prevented from happening again, which strong cross border regulation will help to do.

The Recently Proposed SEC Rule is Inapplicable to the CFTC, Very Weak and No Basis for Further Delay

The SEC's Proposed Rule is based on fundamentally different legal authority

The SEC was given very limited statutory authority in the Dodd-Frank Act related solely to anti-evasion and no mandate at all regarding cross border jurisdiction, as we set forth in the recent Power Point presentation to you and your staff, a copy of which is attached here for reference.[1] In stark and clear contrast, the CFTC was given the same anti-evasion authority **plus** an affirmative statutory mandate to regulate cross border derivatives activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States." (Compare DFA Section 772 (b) [SEC] with Section 722(d) [CFTC]).

Thus, the SEC proposed rule is **entirely inapplicable** to the CFTC's statutory mandate to regulate the risks from cross border derivatives trading and related activities (as distinguished from their shared desire to prevent evasion).

This strong statutory mandate to the CFTC makes sense, of course, because the dark, unregulated derivatives markets was where the last financial crisis was invisibly incubated, grew exponentially and acted as a conveyor belt to transmit the crisis throughout the globe.

The SEC oversees a tiny segment of the derivatives market

The CFTC's broader statutory mandate also makes sense because the CFTC has decades of expertise and jurisdiction for virtually the entire derivatives markets. Indeed, the SEC has jurisdiction for no more than 3.5 percent of those markets.

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[1] Attached is the same presentation we used in our meeting with you other than the clarification on slide 18, which we discussed, and the elaboration of the European process on slides 22-24.

The CFTC has jurisdiction for more than 96.5 percent of the combined swaps and security-backed-swaps markets,[2] in addition to the unique, broad statutory mandate. To think that the CFTC should follow or be influenced by the SEC's recently proposed rule under such circumstances is nonsensical (or perhaps pretextual). It would be as if the SEC deferred to the CFTC to set the regulatory standards for all mutual funds simply because the CFTC required less than 1 percent of mutual funds to also register as a CPO. That would never happen, of course, and it should not be permitted in connection with cross border derivatives regulation.

The CFTC has fully considered its cross border guidance for 2 ½ years, while the SEC is just beginning

It would be irresponsible for the CFTC to wait for the SEC, even as to its very limited anti-evasion provisions.

As you know, the SEC just proposed a rule regarding the anti-evasion cross border provisions on May 1, 2013. Comments are not even due for months, until August 22, 2013. Moreover, given the sprawling 650 page proposal, an extension substantially beyond that deadline is likely.

In contrast, the CFTC has had 2 ½ years of meetings, consideration, deliberation and virtually unlimited input from industry and others. Indeed, the CFTC worked for 1 ½ years before proposing its initial guidance in June 2012 and then worked for another 6 months before issuing further guidance in December 2012. At the same time that it issued the further guidance in December 2012, the CFTC also issued an exemptive order, pushing back the effective date for yet another seven months, to July 12, 2013. The CFTC has received and considered at least 322 filed comment letters and had dozens of meetings.

Thus, the CFTC has thoroughly considered the cross border guidance and has already delayed its effective date multiple times. The time for delay is over.

The SEC's Proposed Rule is weak

Better Markets will comprehensively comment on the SEC's proposed rule in due course. However, even a cursory glance reveals it to be weak and grossly insufficient to protect the American people, even as to the limited requirement of preventing evasion regarding the 3.5 percent of the market relating to security-based swaps. Indeed, the proposal, unless strengthened, will sound the starting gun for a global race to the bottom regarding cross border derivatives regulation.

For example, the release discusses the need to focus on **risk**, but then proposes a rule focused on the **form** of entities, making regulatory arbitrage relatively easy. This is

[2] BIS Annual derivatives market report, 2012. If either DTCC or CFTC-reported data were used, the SEC portion of the markets would decrease to less than 3 percent. *See*, e.g. http://dtcc.com/products/derivserv/data/index.php.

illustrated, for instance, by the fact that it recognizes risk from the activities of overseas guaranteed affiliates, but then excludes them from the definition of "U.S. person." Frankly, by elevating form over substance, the proposal serves as nothing more than an invitation for regulatory arbitrage.

Troublingly, the SEC proposed rule allows broad, almost unlimited substituted compliance—without any real legal justification[3]—which would be based on a so-called "holistic" approach and purportedly comparable "outcomes." Yet, it proposes only four broad categories to evaluate substituted compliance, which will fail to ensure that foreign regulators protect the American people. The SEC proposal also considers irrelevant factors not in the statute, proposes a process that lacks transparency, and fails to ensure public notice or input.

No Current Conflicts with International Laws and No Delay for the World to Catch Up is Justifiable

There is no current conflict with international laws regarding Title VII. That is largely because the United States in general and the CFTC in particular are years ahead of foreign governments and regulators in passing laws and regulations comprehensively governing derivatives.

To now stop the process and wait for the world to catch up would be indefensible. Now is the time for the CFTC to finalize its cross border guidance, triggering a regulatory race-to-the-top to protect the people of the United States and the globe from another derivatives-ignited financial disaster.

As we understand it, the CFTC's office of the general counsel performed a comprehensive review of derivatives laws in Europe and elsewhere ("Review"). That Review identified no conflicts with Title VII or CFTC regulations. We have been informed that the Review was shared with the European Commission (and presumably other foreign regulators), who confirmed the absence of any conflicts. In addition, we have learned that the Review (which we have not seen) was shared with several prominent Wall Street derivatives dealer banks and their expert representatives and that they too agreed with the Review's conclusion that there were no conflicts.

The fact that others have not yet passed comprehensive laws or implemented regulations means that the field is open for the U.S. to continue to lead the way. Let others follow, ideally with equally strong or stronger rules. If there are conflicts later, then the CFTC can address them later. All such claims of conflicts now are hypothetical and speculative, and they do not constitute a legitimate basis for policy making (or for any delay in making policy).

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[3] The term "substituted compliance" does not appear anywhere within the Dodd-Frank Act, the Securities Exchange Act, or any other potentially applicable law.

In particular, the claims and complaints of European governments, regulators and dealer banks are without merit. While the European Markets and Infrastructure Regulation ("EMIR") has been passed, it has not yet been implemented. Furthermore, it addresses only a limited set of regulations, which deal only with clearing and data reporting. Comprehensive Dodd-Frank Title VII-like regulation in the European Union is still years away. MiFID2 and MiFIR, which govern execution, trading, position limits and other issues, will not be finalized for years. Thus, while your position is that the December 2012 exemptive order, scheduled to expire on July 12, 2013, was set so that the EMIR regulation could be finalized, that is not a proper basis to continue to delay.

As detailed in the attached Power Point and in our response to Michel Barnier's recent incomplete and misleading Op Ed in Bloomberg View,[4] Europe has years to go and many hurdles to overcome in a convoluted process that has many parties pulling in many different directions.[5] To us, it would be irrational and indefensible to condition the protection of the American people on those actions, which will only be final at some indeterminate time in the future.

Because Foreign Regulators Have Failed Repeatedly to Protect their Own Taxpayers, Depositors and Treasuries, Outsourcing the Protection of the American People to Them via Substituted Compliance Must Be Carefully Limited (If Used at All)

If substituted compliance is to be used, foreign laws and regulations must be comparable in form, substance, enforcement and over time. Moreover, they must be evaluated on a rule-by-rule basis. Substituted compliance cannot be viewed "holistically" and based on broad, purportedly comparable outcomes or it will become an invitation for regulatory arbitrage.

Moreover, no one should be comforted by anyone's claim that foreign regulators can and will protect American taxpayers. Foreign regulators, and European regulators in particular, failed miserably to protect their own depositors, taxpayers and treasuries. The banks that were nationalized in Europe, many exceeding the GDP of the entire country, have saddled their taxpayers with trillions of dollars in liabilities. Moreover, foreign regulators have a conflict of interest in enforcing strong rules against U.S. derivatives dealers. If they have weaker rules, laws or enforcement, then U.S. firms will move their business, jobs and revenues overseas, while the bill for

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[4] Compare "U.S. Can't Go It Alone on Derivatives" (Barnier) with "European Attacks on U.S. Regulators Must Not be allowed to Weaken U.S. Derivatives Rules" (Kelleher): http://www.bloomberg.com/news/2013-06-20/u-s-can-t-go-it-alone-on-derivatives.html with http://www.huffingtonpost.com/dennis-m-kelleher/european-attacks-on-us-regulators_b_3480021.html .

[5] *See*, e.g., "Hard Bargaining starts on MiFID2," Financial Times, Philip Stafford, June 18, 2013 (*available at* http://www.ft.com/intl/cms/s/0/9c774aee-d800-11e2-9495-00144feab7de.html#axzz2X5r5Nt2D).

their recklessness will be sent back to the U.S., as it was in the cases of AIG, Lehman Brothers, Citigroup, Bear Stearns and so many others.

This is undoubtedly why the Federal Reserve Bank has rejected substituted compliance for foreign banks operating in the U.S.[6] Pre-crisis, it relied on the home countries' regulators to supervise the U.S. operations of foreign banks. The crisis proved that to be a total failure and now, post-crisis, the Fed is requiring foreign bank organizations in the U.S. to set up intermediate holding companies which must adhere to Fed rules applicable to domestic banks.

Cross Border Derivatives Activities Have Already Cost the United States an Enormous Amount

The cross border activities of global derivatives dealers have already cost the United States an enormous amount. The frequently-cited examples of this from the 2008 crisis include Bear Stearns (Cayman affiliates operating in New York with swaps desks in London), Lehman Brothers (swaps book run out of London), AIG Financial Products (French affiliate operating in London) and Citigroup (Cayman affiliates operating in London). Two examples that demonstrate that cross border risks return to the United States, even if they don't cost taxpayers directly, are the JP Morgan Chase "London Whale" loss (London branch) and the Long Term Capital Management collapse (Cayman affiliates operated in London).

But that's not all. The U.S. had to bail out the global financial system in general and foreign banks and dealers in particular. For example, of the 22 AIG counterparties bailed out by the U.S. government, 17 were foreign banks. Of the 20 largest users of Federal Reserve Bank's emergency lending facilities, nine were foreign banks. Also, the Fed pumped $1.9 trillion into foreign swap lines in the 30 days after the collapse of Lehman Brothers and $5.4 trillion in the 90 days after its collapse.

Protecting the American people from the devastation of another financial crisis and another long list of costly bailouts is what is at stake in the cross border guidance. It should be done without delay and in as protective a way as necessary. The American people deserve no less.

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6 *See* Federal Reserve Board of Governors Proposed Rule "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Regulation YY, Docket Number 1438, RIN 7100 AD 86)" *available at* http://www.stlouisfed.org/regreformrules/Pdfs/2012-12-28_FRS_proposed_enhanced_standards_foreign_organizations.pdf.

<u>The Costs to the United States of the Last Financial Crisis Have Been Staggering and Must be Prevented from Happening Again</u>

Too much of the financial reform discussion is antiseptic, academic, bloodless and ahistorical. Regulators, lobbyists, lawyers and other Wall Street allies all focus on each rule as if it were an end in itself. The purpose of a rule, its connection to comprehensive regulation and reform, and the financial and economic crises giving rise to it are never mentioned by those importuning the CFTC to write rules that protect their business lines and profits. While they always talk of liquidity, working markets, growth, etc., never forget that those ostensible concerns always happen to coincide with their economic interests. Healthy skepticism about their claimed magnanimous concerns is vital if the real public interest is to be served.

The financial crash of 2008 was the worst financial collapse since 1929 and it ushered in the worst economy since the Great Depression. The ongoing costs of those historic events to the people, communities and government of the United States will be more than $12.8 trillion over ten years (not including the costs of the Fed's zero interest rate policy and asset purchases, all of which have been necessitated by the massive damage done by the financial collapse). [7]

Of course, the dollar cost, almost unimaginably large, will still never capture the human suffering and economic wreckage inflicted on our country from coast to coast by the financial and economic crises. Financial reform in general and Title VII in particular were passed to prevent that from happening again. The regulation of cross border derivatives trading and activities that have a direct and significant effect on the U.S. are an essential part of that framework.

<u>CONCLUSION</u>

As we have made clear in our several comment letters,[8] strong cross border guidance is vital not just to derivatives reform and Title VII, but to all of financial reform and the implementation of the Dodd-Frank Act. While the rulemaking process tends to silo discussions on a rule-by-rule basis, Congress didn't pass a law merely directing that

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[7] *See* BETTER MARKETS, THE COST OF THE WALL STREET 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.

[8] "Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)" (August 16, 2012) *available at* http://bettermarkets.com/sites/default/files/CFTC-CL-%20Cross%20Border%20Delay-%208-16-12.pdf; "Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)" (August 27, 2012) *available at* http://www.bettermarkets.com/sites/default/files/CFTC-%20CL-%20Cross%20Border%20Application%20of%20swaps%20provisions%208-27-12.pdf; and "Proposed Further Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD85)" (February 15, 2013) *available at* http://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Cross-Border%20further%20guidance-%202-15-13.pdf, incorporated here as if fully set forth.

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a number of isolated, discrete rules be passed. It enacted broad, comprehensive financial reform as an integrated whole with layers of inter-related protections and this rule must be considered in that context.

After 2 ½ years of consideration, and massive and unlimited input from Wall Street and others, it is time for the CFTC to protect the American people from high risk cross border derivatives trading that has a direct and significant impact on the U.S. We hope this information is helpful to you in coming to the same conclusion.

Sincerely,

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