AMERICANS FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

Americans for Financial Reform
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Commodities Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington DC, 20581

Dear Chairman Timothy Massad:

This week, the Commission faces key decisions in finalizing a crucial protection against derivatives risk, namely the rules governing mandatory provision of margin for derivatives transactions. In our initial letter to the Commission on its proposed margin rules, we outlined the importance of requiring advance margin provision in derivatives transactions, highlighting the incredible $2.7 trillion in increased margin demands over less than two years during the financial crisis of 2007-2008 and the stress that put on the financial system.[1] By requiring routine margin for derivatives, especially initial margin which provides a key buffer against future price changes and unforeseen increases in exposures, these rules will help to ensure that derivatives users understand and plan for the risks created by derivatives.

In this letter, we wish to address one important area of these margin rules, namely requirements for inter-affiliate margin in transactions between swap dealers and affiliated entities. This issue has taken on increased prominence in recent months due to intense lobbying by major Wall Street banks to reduce or eliminate requirements for initial margin in inter-affiliate transactions. The margin rule recently finalized by prudential regulators did weaken inter-affiliate margin standards somewhat, but retained the critical requirement that affiliates and subsidiaries of insured depository institutions (IDIs) post initial margin in swaps with the IDIs. By retaining this requirement, the prudential regulators protected depository subsidiaries and the public. The initial margin requirement is particularly important since, as mentioned above, it is this type of margin that provides a buffer against the kind of rapid unanticipated changes in exposures that can occur during situations of financial stress.

We urge the Commission to, at minimum, retain a similar requirement with respect to the most significant entities that you supervise, namely registered swap dealers. The Commission's October, 2014 re-proposal on margin rules included a comprehensive set of requirements for

[1] Americans for Financial Reform, "Letter Re Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", December 2, 2014.

inter-affiliate margin. In the final rule, you should at least require that affiliates and subsidiaries of swap dealers post initial margin in any inter-affiliate transaction with a swap dealer.

We realize that the swap dealers regulated by the Commission differ from IDIs, in that they do not benefit from deposit insurance provided by the U.S. government. However, this difference does not negate the systemic importance of providing inter-affiliate margin protections for these entities. These swap dealers are generally key subsidiaries within large, complex global financial institutions that have numerous major operating subsidiaries active in dozens of countries. Requiring margin for inter-affiliate transactions involving such major subsidiaries is extremely important for orderly resolution of these institutions. The experience of the 2008 financial crisis showed us that the orderly resolution or recovery of large global financial institutions is crucial to the stability of the overall financial system, even when they do not include a major insured depository bank. The disorderly failure of Lehman Brothers, a large global financial firm that did not include a significant IDI but was a major player in global derivatives markets, clearly had a massive impact on financial stability.

Permitting significant un-margined derivatives exposures involving key affiliates of large global financial institutions means that financial distress will spread much more rapidly within these entities, from a single troubled affiliate to other parts of the institution. It will mean that the top management of the firm will have fewer options in remediating distress, for example by selling a major subsidiary entity. Such a recovery plan will be more difficult if the subsidiary has many un-margined exposures to other affiliates, exposures that would have to be margined prior to sale. Finally, these un-margined exposures will present a major barrier to the rapid and orderly resolution and restructuring of a failing international financial firm, either by regulators or by the courts in bankruptcy. This barrier would be even greater because it is likely that un-margined derivatives exposures would extend across national borders, meaning that a swap dealer would more likely to be exposed to subsidiaries in other jurisdictions operating under different bankruptcy laws or possibly resolution regimes. By making resolution more difficult, a broad exemption from inter-affiliate margin would contribute to the problem of "too big to fail."

FDIC Chairman Gruenberg highlighted this problem in a speech earlier this year on orderly resolution Chairman Gruenberg described the problem of interconnections within large complex financial institutions and the issues it creates for orderly resolution and financial stability[2]:

> "The actions the firms are being required to take focus in particular on reducing the interconnectedness between legal entities within the firms….These firms are extremely complex with hundreds, if not thousands, of legal entities, which operate on a business line—not legal-entity—basis. While business lines stretch across multiple legal entities, foreign and domestic, failure occurs on a legal-entity basis. The inability to resolve one

[2] Federal Deposit Insurance Corporation Chairman Martin J. Gruenberg, Speech at the Peterson Institute for International Economics, "A Progress Report on the Resolution of Systemically Important Financial Institutions" (May 12, 2015), https://www.fdic.gov/news/news/speeches/spmay1215.html.

legal entity without causing knock-on effects that may propel the failure of other legal entities within the firm makes the orderly resolution of one of these firms extremely problematic.

To improve resolvability, firms must…address cross-guarantees and potential cross-defaults that spread risk and tie disparate legal entities and operations together…Actions that promote separability of material entities will lessen the problem of knock-on effects created by interconnectedness, potentially allowing a firm to place its troubled entity into bankruptcy, or its existing resolution regime. Such an outcome would increase the likelihood that failure would be orderly, minimizing any potential instability for the financial system as a whole, a problem that greatly influenced policymakers' responses in 2008."

Any rule which did not require inter-affiliate transactions between key subsidiaries in a global banking group to be fully margined would work directly against the goals laid out by Chairman Gruenberg here. Un-margined derivatives transactions create large credit exposures between subsidiaries that lead to precisely the 'knock-on effects' and cross-defaults that spread risk rapidly within a major financial institution. They create major practical problems in separating a single failing subsidiary from the rest of the institution and resolving that subsidiary on a stand-alone basis.

We realize that in our divided financial regulatory system the CFTC does not have any direct responsibility for orderly resolution of a failing financial firm. Yet experience of the 2008 financial crisis and also the creation in Dodd-Frank of a Financial Stability Oversight Council (FSOC) that includes the CFTC, shows that the Commission should make every effort to coordinate with other regulators and to consider the effects of its rules on broader issues of financial stability. We thus urge the Commission to retain key margin protections and to consult carefully with the prudential regulators, through the FSOC and directly, concerning the implications of inter-affiliate margin for resolution of large complex entities and for financial stability more broadly.

Such consultation could also include discussion of regulatory arbitrage issues that could be created by a significant divergence between margin requirements for inter-affiliate transactions involving IDIs and those involving major subsidiaries of financial institutions that were swap dealers but not IDIs. Some have claimed that the funding advantages that exist for IDIs justify exempting non-IDI subsidiaries from margin requirements. Americans for Financial Reform has favored, and continues to favor, additional action to separate derivatives dealing from insured depositories. However, exempting non-IDI swap dealers from basic risk protections such as margin requirements would be a completely inappropriate response to concerns regarding the intermingling of swap dealing and publicly insured deposits. As discussed above, these exemptions would create significant barriers to effective recovery and resolution of major international financial institutions crucial to financial stability. They would also not be effective in actually addressing the problem of funding derivatives dealing using insured deposits.

The CFTC's original margin proposal, while not perfect, did lay out a comprehensive set of basic margin protections for derivatives transactions. We urge the Commission not to weaken its original proposal by providing broad exemptions from inter-affiliate margin requirements.

Please contact AFR's Policy Director, Marcus Stanley, at 202-466-3672 or marcus@ourfinancialsecurity.org if you wish to further discuss the issues in this letter.

Sincerely,

Americans for Financial Reform

Cc: Members of the Financial Stability Oversight Council

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America

- Greenlining Institute
- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices

- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG

- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG

- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET