INSTITUTE FOR AGRICULTURE AND TRADE POLICY

Representative
U.S. House of Representatives
Washington, DC

June 16, 2014

Electronically transmitted

Dear Representative,

I write on behalf of the Institute for Agriculture and Trade Policy (IATP) a non-profit, non-governmental organization based in Minneapolis, MN to urge you to vote against H.R. 4413, "Customer Protection and End User Relief Act."[sic][1] A vote for H.R. 4413 annuls or amends major portions of Title VII of the Dodd Frank Act Wall Street Reform and Consumer Protection Act (DFA) and per Title IV's retro-active application to July 2010, makes regulations and guidance issued under the DFA authorities vulnerable to legal challenge by the regulated entities.

Furthermore, if enacted, HR 4413 would impede DFA Title VI implementation by, among other measures:

1) preventing the cross-border application of DFA authorized rules unless the Commodity Futures Trading Commission and the Securities Exchange Commission jointly determine that foreign jurisdiction rules are not "broadly equivalent" to DFA rules (Section 359);

2) micro-managing the CFTC Division Directors, Chief Economist and staff (Sections 204, 205 and 206);

3) micro-managing and possibly impeding CFTC enforcement activities (Section 209);

4) imposing cost-benefit analysis of each CFTC rule prior to implementation, and as required of no other independent agency, under terms that would paralyze CFTC rulemaking that did not conform to industry demands (Section 203); and

5) by requiring that CFTC voluntary guidance to industry be subject to the same Administrative Procedures Act (APA) requirements as for legally binding rulemakings (Section 212).

IATP began to work on commodity derivatives issues in June 2008, when grain elevators stopped forward contracting with farmers and rural banks stopped loaning to elevators, due to extreme price volatility and price levels in commodity derivatives markets, which resulted from excessive speculation by financial institutions.[2] IATP has participated in the Commodity Markets Oversight Coalition (CMOC) since 2009, and the Derivatives Task Force of Americans for Financial Reform (AFR) since 2010. IATP has contributed to and signed on to numerous CMOC and AFR letters in support of Title VII of the DFA. IATP has submitted several comments on CFTC rulemaking, and on consultation papers of the International Organization of Securities Commissions, the Financial Stability Board, the European

[1] http://docs.house.gov/billsthisweek/20140616/CPRT-113-HPRT-RU00-HR4413.pdf

[2] See the annotated bibliography of about a hundred studies compiled by Markus Henn, "Evidence on the Negative Impact of Commodity Speculation by Academics, Analysts and Public Institutions," November 26, 2013, WEED. Available at http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf .

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Securities and Markets Authority, and the European Commission's Directorate General for Internal Markets.

H.R. 4413 offers terrible trade-offs that no member of Congress should be forced to vote for. As H.R. 4413 is constructed, you can only vote for the widely agreed customer protections in Title I, if, e.g. you also vote to require the CFTC Commissioners to vote on the length of a subpoena, the renewal of the subpoena and whether the Division of Enforcement has a "legitimate purpose" for each investigation it undertakes (Section 209). Title I could and should be proposed as a separate bill, for which you should be able to get sponsors from Republicans, as well as Democrats.

IATP also requests that you propose and vote for deletion or amendment of certain sections of the bill, because its passage is very likely. It is crucial that there be recorded votes on all amendments to or deletions of H.R. 4413. Here are IATP's top five priorities for deletions, since amendments may not be possible, given the short amount of time before the amendment deadline of Tuesday at 3.p.m. ET.

1. Section 359: This section (paragraph a) first requires the CFTC to issue rules jointly with the Securities Exchange Commission on the cross-border application of DFA rules. The CFTC has authority over about 96.5% of the gross notional value of the U.S. derivatives market, whereas the SEC has authority over 3.5% of this market.[3] The SEC has authority over just one asset class of derivatives, equity-based derivatives. The House would give equal rulemaking authority with the CFTC to an agency that has historic competence and legal authority for only a small sliver of the derivatives market. This section further seeks to impede the CFTC's ability to apply DFA authorized rules to foreign affiliate swaps of U.S. swaps dealers that have a "direct and significant" impact on the U.S. economy (Sect. 722, DFA). It does so first by requiring that the CFTC's international memoranda of understanding (MoUs) with foreign market regulators comply with APA requirements for binding rulemaking (paragraph c). MoUs are not binding rules, but diplomatic agreements whose implementation and enforcement does not depend entirely on U.S. law or regulations. Here, again, HR 4413 seeks to micro-manage the CFTC's work, this time in negotiations with foreign governments.

   Most perniciously, Section 359 grants a blanket exemption from compliance with DFA authorized derivatives rules for "Countries or Administrative Regions Having Nine Largest Markets," [sic] unless the CFTC and SEC "jointly determine that the regulatory requirements" of these countries and regions are not "broadly equivalent" to U.S. regulatory requirements (paragraph d). Given the aforementioned huge disparity in the "market share" of the CFTC's and SEC's authority over the swaps market, this co-determination requirement is grotesque. Furthermore, taking into account the markets in the 28 member states of the European Union, plus the next eight largest market jurisdictions, Section 359 exempts more than 90 percent of the foreign swaps market from compliance with the cross-border application of the DFA. The seven largest U.S. bank holding companies have 4939 foreign subsidiaries[4] and thousands of more affiliates. Trading losses by these subsidiaries and affiliates resulted in default cascades by their U.S. parent companies, saved from bankruptcy only by at least $19 trillion in emergency loans from the Federal Reserve Bank, plus $10 trillion to foreign central banks to bail out their banks with U.S. affiliates

[3] "CFTC Cross-Border," Better Markets, June 21, 2013.
https://www.bettermarkets.com/sites/default/files/CFTC%20Cross-border-%206-21-13.pdf

[4] Dafna Avraham, Patricia Selvaggi and James Vickery, "A Structural View of U.S. Bank Holding Companies", FBRNY Economic Policy Review, July 2012, Table 1: "Number and distribution of subsidiaries: Selected Top 50 Bank Holding Companies", 71. http://www.newyorkfed.org/research/epr/12v18n2/1207avra.pdf

from 2007-2010.[5] The regulatory regimes of the foreign jurisdictions to which the Fed loaned at ultra-low interest rates had been judged to be "broadly equivalent" during the Bush Administration.

2. Section 203: Cost Benefit Analysis. The CFTC, unlike other independent regulatory agencies, is required to do a cost-benefit analysis prior to each regulation it issues. This section does not operate consistently with Executive Order 13563, as House supporters claims, since 13563 applies only to non-independent agencies. Paragraph H requires the CFTC to tabulate the costs of compliance by "all regulated entities," in effect requiring the CFTC to accept as fact the compliance costs claimed by the regulated entities. These claimed compliance costs often have been shown to be wildly overstated.[6] Paragraph J requires that the CFTC demonstrate prior to implementation that each of the agency's regulatory approaches "maximize net benefits." These two paragraphs alone should ensure that DFA authorized rules are not implemented unless they satisfy the cost-benefit demands of the regulated entities. Ex-ante cost-benefit analyses traditionally are done on the basis of econometric modeling[7], and not by the peculiar dependence on regulated entity claims featured in this section.

3. Section 209: Subpoena duration and renewal. This section authorizes the Commissioners to determine the length of a subpoena that the Division of Enforcement shall use to compel testimony and production of documents relative to an investigation. It will require the Commission to vote on whether the Division of Enforcement has a "legitimate purpose" for requesting the subpoena, what the duration of the subpoena will be and whether to renew the subpoena. Well-funded subjects of an investigation will be advised by their lawyers to delay complying with any subpoena in the event that a majority of Commissioners decides to override the Division of Enforcement and not renew a subpoena. It is one thing to disagree with an investigation. It is quite another for the House to vote for a section that would impede enforcement of the law.

4. Section 204: Division Directors. This section requires that each Division Director report to and be reviewed ("serve at the pleasure of") by each Commissioner. In the event that the Commissioners disagree about any activity of a Division, the Division Director could be taking contradictory instructions from the Commissioners. Disagreements among Commissioners must be resolved among the Commissioners and not transmitted to Division Directors in the form of contradictory orders. This section offers a high degree of opportunity for one Commissioner to paralyze the work of the Commission. At best, the section ensures delay of DFA implementation through Commission micro-management of Division Directors and the staff (see also our Comments on Section 205 and 206).

[5] James Andrew Felkerson,"$29,000,000,000,000: A Detailed Look at the Fed's Bailout by Funding Facility and Recipient," Levy Economics Institute, Working Paper 698, December 2011. http://www.levyinstitute.org/pubs/wp_698.pdf

[6] E.g. Dennis Kelleher, Stephen Hall and Katelynn Bradley, "Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC," Better Markets, July 30, 2012. http://www.bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf

[7] E.g. "Macro-economic costs and benefits of OTC derivatives regulatory reform", Bank for International Settlements, August 2013, 2. http://www.bis.org/publ/othp20.pdf

5. Section 353: While the title of this section indicates that it would give "relief" from record-keeping to farmers and grain elevator participants in the derivatives market, the application in the exemption from record-keeping could and almost certainly will be applied to much larger participants in the derivatives markets. By requiring only a written record of the final agreement of swaps for participants in unregistered designated contract markets or swaps execution facilities, this section precludes the CFTC from seeking interim documentation of swaps transactions, including cell phone records if needed. This section makes constructing audit trails in investigations more difficult and otherwise limits enforcement activities.

Other sections that IATP believes you should consider for deletion from HR 4413 include:

Section 205: The Office of the Chief Economist. This section requires that the Chief Economist report to and be reviewed by each Commissioner. Our concerns are the same as those of Section 204

Section 206: This proposal to require a seven day advance notice to review each and every staff letter and to allow the Commission to delay, review and revise staff letters, puts the Commission in charge of micro-managing the staff. Many of the staff no action letters that are the subject of the complaint in the House agricultural committee report on HR 4413[8] are the result of the need to reply to industry questions and complaints, and to postpone compliance by foreign affiliates of U.S. swaps dealers, as foreign jurisdiction rulemaking is delayed by industry opposition. A staff whose budget, personnel and computer infrastructure has been severely constrained by the House has operated as efficiently and effectively as their meager resources allow. This section is not an attempt to improve CFTC transparency and openness but another tactic to micro-manage the staff.

Section 211: Requires that CFTC voluntary guidance to industry be subject to the same Administrative Procedures Act (APA) requirements as legally binding rulemakings. This section represents the plaintiff's position in a court case involving the CFTC's guidance on the cross border application of DFA rules and would pre-empt the result of that case.[9] If the House wishes to require that APA procedures for issuing guidance are the same as for rulemaking, it should amend the APA, rather than single out one agency for this peculiar pre-emption of a court ruling and unique application of the APA to one agency.

Section 212: This section allows plaintiffs to file a lawsuit in the District of Columbia or "in the circuit where the party resides or has the principal place of business" (paragraph a). If the CFTC were a self-financed regulatory agency or had a budget corresponding to its greatly expanded duties under the DFA, the extra costs of litigating outside the District of Columbia might not be a financial burden for agency. Given the House's budgetary expression of hostility to the CFTC, this section represents another tactic to increase the burden on the agency to defend the DFA in court.

Section 352: One of the advantages of trading Over the Counter is the delay in reporting, relative to the near real time reporting required of exchanges for futures and options contracts. OTC traders take advantage of price, volatility and other information provided by the public and regulated markets while providing no information of their own, a huge competitive advantage. This section would allow traders of uncleared and "illiquid swaps" to delay reporting up to 30 days after a trade's execution, an eternity in financial markets, to protect the identity of individual traders. Because swaps can be structured to be illiquid, this section does not consider that the exemption from reporting in near real time could be part of a regulatory evasion strategy. If the industry wishes to petition the CFTC for a reporting exemption on illiquid swaps, let it do so. Legislators should not be involved in designing reporting exemptions.

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[8] http://www.gpo.gov/fdsys/pkg/CRPT-113hrpt469/pdf/CRPT-113hrpt469.pdf at 19

[9] "SIFMA, ISDA and IIB File Lawsuit Challenging Commodity Futures Trading Commission's Cross-Border Rule (sic)," International Swaps and Derivatives Association, December 4, 2013. http://www2.isda.org/search/page/6

Section 355: The asset class indiscriminate de minimis of $8 billion of swaps dealing before a swaps dealer is required to register with the CFTC and be subject to CFTC rules may be lowered only with a vote of the Commission. It is dangerous to remove the CFTC's regulatory discretion in determining the justification for a de minimis. Whereas $8 billion of interest swaps is a low de minimis relative to the more than $150 trillion annual gross notional value of interest rate swaps, an $8 billion de minimis is a very, very high de minimis for commodity swaps. Again, here is another section where the House is acting to micro-manage the CFTC's rulemaking discretion and authority.

In sum, notwithstanding Title I on customer protections and some sections of Title II and III, HR 4413 is a bill that reauthorizes the CFTC, only to impede it from carrying out its statutory duties. IATP urges you to vote against this bill and to vote to delete the aforementioned sections. I would be pleased to work with your staff on any amendments or deletions that you may wish to offer. Thank you for your consideration of our views on HR 4413.

Respectfully,

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