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Swaps bills slated for May 7 HFS vote

On behalf of the 300,000 members and supporters of Public Citizen, we urge you to OPPOSE a package of derivatives deregulation bills tentatively schedule for a House financial services committee vote May 7, at 10:00

Generally, these measures serve the profit interests of a few large Wall Street banks, while threatening to undermine safeguards informed by the 2008 financial crash. Proponents mascquerade them as helping Main Street, or the "international competitiveness" of these few American mega-banks.

On May 6, Treasury Secretary Jack Lew wrote the committee to oppose the bills as undermining "an important part of the reforms put in place to strengthen our financial system."

Public attention to this otherwise complicated area has grown keener, as epitomized by the May 1, 2013 front page New York Times analysis.

H.R. 634*, the Business Risk Mitigation and Price Stabilization Act of 2013*

H.R. 677*, the Inter-Affiliate Swap Clarification Act*

H.R. 992*, the Swaps Regulatory Improvement Act*

H.R. 1003*, To improve consideration by the Commodity Futures Trading Commission of the costs and benefits of its regulations and orders*

H.R. 1062: To improve the consideration by the Securities and Exchange Commission of the costs and benefits of its regulations and orders

H.R. 1256*, the Swap Jurisdiction Certainty Act*

HR 1256

This bill let's American swaps dealers escape US oversight by conducting business in a foreign country. On the surface, the bill requires that the SEC and CFTC jointly determine that the foreign affiliates of U.S. firms are not regulated by foreign governments under a regime that is "broadly equivalent" (Sec. 2(d)(1)) . In practice, such language will make it difficult for US regulators to assert oversight.

- Requiring two agencies jointly to declare that a foreign country is unworthy of prudential oversight will be politically improbable.
- Why do US banks want, say, UK instead of US supervision of their UK operations, if they claim the rules would be the same? Because they understand the rules of and oversight by foreign governments will be laxer.
- Because a foreign government isn't likely to bailout a US firms, rules and supervision will be concomitantly looser. In fact, countries may "race to the bottom" in rules in a bid to attract swap trading and its lucrative personal income tax revenue from bonus-paid traders.
- CFTC Chair Gary Gensler argues that this provision will essentially make Title VII of Dodd-Frank meaningless.
- Litigators such as Eugene Scalia, who seized on two words in the CFTC position limits/commodity speculation statute to stop this rule in court, will be well pleased with the opportunities provided by the "broadly equivalent" language. Does it mean rules written in the same English language as CFTC rules? Or rules that have some of the same words?
- US banks claiming this will harm their international competitiveness must explain why expanding business in Britain builds American employment.

HR 992.

This bill effectively repeals the Lincoln amendment (Dodd-Frank 716) that "pushes" swaps trading out of insured banks into affiliates. Under this bill, taxpayer-backed banks would be allowed to act "as a swaps entity for swaps," as provided in (d)(1)(B). This replaces language in current law in Dodd-Frank Section 716, under (d)(2) that restricts taxpayer-backed banks to act "as a swaps entity . . . involving rates or reference assets that are permissible for investment by a national bank."[1] In other words, instead of dealing in swaps for relatively safe securities such as interest rate swaps, HR 992 opens the door to speculation in anything—commodities, synthetic CDS indices, etc.

- Banks want to gamble through the taxpayer-funded bank. Insured banks make more money dealing swaps that way than through affiliates. That's because of the taxpayer backstop. But that's not appropriate use of the taxpayer backstop
- The Volcker Rule forbids proprietary trading—bank gambling. But it permits banks to make markets, which could mean they can buy risky swaps they can't resell easily. This speculative activity should be moved to a separate affiliate not backed by taxpayers. Wall Street complains that this would harm "liquidity" must answer why taxpayers should subsidize liquidity for risky swap dealing.
- The Chamber of Commerce claims this would force businesses to deal with multiple divisions at a bank. Yet the mega-banks, such as JP Morgan, maintain thousands of affiliates for regulatory or tax convenience. If the Chamber wants to deal with just one JP Morgan affiliate, it can simply ask the company. The bankruptcy court continues to wade through

[1]". . . under the paragraph designated as ``Seventh'' of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), other than as described in paragraph (3)."

hundreds of thousands of swaps from Lehman brothers, owing to legal differences and claims between those affiliates.

- Swaps are a gambling market for only large banks; more than 90 percent of trades are between financial institutions, and 90 percent of these are between the five largest banks. The other 7,176 banks don't traffic in swaps.
- "Pushing" swaps out of taxpayer-insured banks into separately capitalized affiliates may reduce swap trading. Yes, it would reduce banker bonuses from trading. Yes, it may reduce "liquidity" by a miniscule amount for this gambling market. But these effects of reducing the safety net subsidy to swap dealing are minor compared to the costs of reducing the risk of another financial crisis. America built railroads, developed the automobile, airplane, pharmaceutical and computer industries without the swaps developed in the last ten years. In fact, since the emergence of this "liquid" swaps gambling market, finance has become more expensive, less efficient, than before such "innovation" beset Main Street.
- Do regulators generally support this as "technical" fix? Fed Chair Ben Bernanke has lobbied against the "Lincoln" amendment since 2010. But his view does not represent Fed policy. S Former FDIC Chair Sheila Bair wrote that swaps dealing should be in separate affiliate. Ditto FDIC Vice Chair Hoenig, and Dallas Fed CEO Fisher.

HR 677

This bill eliminates regulation for swaps between affiliates of a bank. It declares that such swaps aren't, in fact, swaps (Sec. 2, a. (1) (G) (i)). It also removes prudential safeguards such as clearing and margin.

- In conjunction with HR 1256, mega-banks can swap between a US affiliate and a London affiliate, escaping US supervision. The regulators (CFTC) already exempt certain inter-affiliate swaps from many prudential requirements.
- Turning a swap into a non-swap (if it travels between affiliates) is ostrich policy that ignores existence of risk.
- When firms go bust, as Lehman did, settling swap bets can be intractable. Five years after the bankruptcy, hundreds of thousands of swaps remain unsettled. Lehman recently sued Intel over swap deal with unclear lines of responsibility for valuing collateral owing to the fact that Lehman traded the swap between its affiliates
- Not all affiliates are equal. A bank may share ownership of an affiliate with another firm. What if that other firm fails and walks away from the bet?

HR 634

This bill forbids regulators from the ability to require banks to require “margin” from Main Street business.

- This legislation is unnecessary, as the relevant regulators have already exempted end users from margin by rule.
- The legislation would eliminate the only statutory authority that the SEC and CFTC have to require margin for uncleared swaps at non-bank dealers. This authority could be very significant in a future crisis. It is unwise to remove a prudential tool that regulators might use. Already, regulators have declared the conditions where margin would not be required. See the results when Congress approved the Commodity Futures Modernization Act, which prevented the CFTC from overseeing OTC swaps.
- Claims that margin “ties up capital” implies that swaps are somehow free. Banks don’t deal swaps with businesses for philanthropy. Safety measures otherwise provided by margin are reflected in price, or demand for collateral. Preventing margin does not somehow make swaps “cheaper” for end-users. See MIT Prof. John Parsons.

HR 1062

This bill adds a strict statutory cost analysis for securities regulations. In Sec. 2(e)(1), the bill effectively empowers the SEC to ignore a Congressionally mandated rule if it decides it is “unwarranted.” The SEC chief economist is given a personal veto over any rule if this officer finds that benefits do not outweigh costs.

- If the SEC chief economist believes the benefits of issuers under the JOBS Act don’t outweigh the costs of potential fraud to investors, including unintended consequences, this simple opinion can negate the JOBS Act.
- Among the impossible assignments, the SEC must list all unintended consequences. By nature, some unintended consequences are unknowable. (See Godels’ theorem.) Another name is “unforeseen consequences.”
- This bill will hamstring the regulatory process at the SEC.