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## COMMENT

June 2, 2011

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st St., N.W.  
Washington, D.C. 20581

Re: RIN 3038-AC96 – Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants

Dear Secretary Stawick:

We are writing on behalf of UNITE HERE (“UH”) and appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (“CFTC” or “Commission”) regarding the CFTC’s proposed rule entitled “Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants” (“Proposed Rule”) under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

UNITE HERE (“UH”) represents 250,000 workers throughout the U.S. and Canada who work in the hotel, gaming, food service, manufacturing, distribution, laundry and airport industries. UH supports the legislative intent of Dodd-Frank to reduce risk, increase transparency, and promote integrity within the financial system. It is critical that the rules adopted by the CFTC are consistent with the legislative intent of Dodd-Frank.

The Proposed Rule would establish conflicts of interest requirements for swap dealers, major swap participants, futures commission merchants, and introducing brokers. To ensure effective implementation of the Proposed Rule, there must be objective oversight and enforcement. Therefore, monitoring of the firms’ policies and procedures on conflicts of interest should be carried out at the Commission level, not by the Self-Regulatory Organization (“SRO”).

In particular, UH supports proposed rule 23.605(e), which would require that swap dealers and major swap participants “adopt and implement written policies and procedures that mandate the disclosure to its counterparties of any material incentives and any material conflicts of interest regarding the decision of counterparty” on the execution or clearing of a transaction.<sup>1</sup>

<sup>1</sup> Federal Register, Vol. 75, No. 225, Tuesday, November 23, 2010.

However, as stated above, conflict of interest policies and procedures must be monitored and enforced at the Commission level.

### ***The inadequacy of SRO Oversight and Enforcement: Deutsche Bank Example***

As witnessed during 2007 and 2008, Wall Street banks and other financial institutions failed to manage conflicts of interests which, in turn, caused substantial damage to financial markets and the broader economy.<sup>2</sup> Millions of Americans lost their jobs, homes and businesses. At the same time, the US government provided capital and liquidity to hundreds of banks and insurers as part of the \$700 billion Troubled Asset Relief Program. Approximately \$180 billion in bailout funds were committed to the rescue of the American Insurance Group (“AIG”) alone, which failed and was rescued by the government primarily because of its enormous sales of credit default swaps.<sup>3</sup> The bipartisan Financial Crisis Inquiry Commission (“FCIC”) Report concluded: “AIG’s failure was possible because of the sweeping deregulation of over the counter (OTC) derivatives, including credit default swaps...”<sup>4</sup>

Deutsche Bank AG (“Deutsche Bank”), a global investment bank and one of the largest swap dealers in the world, benefited from \$11.8 billion in American taxpayer dollars through the AIG bailout.<sup>5</sup> As a leading derivatives dealer, Deutsche Bank has engaged in some of the same conflicts of interest that Dodd-Frank seeks to remedy. Consider the following recent examples:

- **Deutsche Bank sold “crap” and “pigs” to clients.** As detailed in a recent US Senate Permanent Subcommittee on Investigations report, Deutsche Bank sold Collateralized Debt Obligations (“CDO”) whose underlying mortgage securities the bank’s top CDO trader privately disparaged as “crap” and “pigs.”<sup>6</sup> According to testimony before the FCIC, Deutsche Bank had been alerted by a due diligence firm about the problematic mortgage bonds it was putting into CDOs in 2006-07.<sup>7</sup> However, despite this warning, skyrocketing mortgage delinquencies, growing RMBS losses, and the exit of most sophisticated investors from the US mortgage market, Deutsche Bank issued 15 new CDOs securitizing nearly \$11.5 billion of primarily mortgage related assets from December 2006 to December 2007.<sup>8</sup>

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<sup>2</sup> See “Failing to Manage Conflicts of Interest,” in US Senate Permanent Subcommittee on Investigations, “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,” April 13, 2011, pp. 376-635.

<sup>3</sup> Financial Crisis Inquiry Commission Report, “Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States,” January 2011.

<sup>4</sup> *Ibid.* *Emphasis added.*

<sup>5</sup> Congressional Oversight Panel, “August Oversight Report: The Global Context and International Effects of TARP,” August 12, 2010. See also American Insurance Group, “Collateral Postings Under AIGFP CDS,” 9/16/08-12/31/08.

<sup>6</sup> US Senate Permanent Subcommittee on Investigations, “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,” April 13, 2011.

<sup>7</sup> Testimony of Vicki Beal, Senior Vice President, Clayton Holdings before the Financial Crisis Inquiry Commission, September 23, 2010. See, in particular, “All Clayton Trending Reports,” 1<sup>st</sup> Quarter 2006 – 2<sup>nd</sup> Quarter 2007.

<sup>8</sup> US Senate Permanent Subcommittee on Investigations, “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,” April 13, 2011.

- **“Playing both sides of the fence.”** As the *Wall Street Journal* has reported, while creating and selling CDOs to some of its clients, Deutsche Bank “was not only advising other clients to bet the other way, but also sometimes doing so itself.”<sup>9</sup> Deutsche Bank made a \$5 billion short investment against the CDO market and produced \$1.5 billion in bank profits.<sup>10</sup> The *Journal* added: “Deutsche’s actions are a vivid example of potential conflicts on Wall Street—the way big financial firms play both sides of the fence with investors.”<sup>11</sup>
- **“Gross conflicts of interest.”** In March 2011, Germany’s highest civil court ruled that Deutsche Bank failed to properly advise its client, Ille Papier, a small paper company based near Frankfurt, of the risks of interest-rate swaps. Germany’s Federal Court of Justice ruled that “Deutsche Bank had a duty to disclose all risks to its client, as well as the bank’s potential profit, because of its ‘gross conflicts of interest’ in marketing a product whose risk was stacked to the bank’s advantage and ‘at the expense of the client.’”<sup>12</sup> In a case in Italy, Deutsche Bank and other financial institutions are on trial over allegations that they “misled Milan officials about their potential profits from arranging an interest-rate swap deal for the city government.”<sup>13</sup>

Ironically, Deutsche Bank has now appealed to the CFTC to implement and enforce conflict of interest systems at the SRO or entity level:

*Procedures to monitor a firm’s swaps activities, such as risk management procedures, conflict of interest systems, trade monitoring mechanisms and recordkeeping regarding corporate, financial and compliance matters typically operate at the entity level. In deciding how to apply their rules requiring these procedures to foreign banking entities, the Commissions should take account of the fact that many foreign banks already have in place extensive control mechanisms, which are subject to existing home country rules and supervision as well as imminent derivatives-specific regulation.*<sup>14</sup>

The International Swaps and Derivatives Association, of which Deutsche bank is a member, and other industry lobbying groups share a similar point of view: “We respectfully request that the Commission allow for SRO oversight and enforcement of the Proposed Rules.”<sup>15</sup>

<sup>9</sup> Wall Street Journal, “Dual Role in Housing Deals Puts Spotlight on Deutsche,” August 3, 2010.

<sup>10</sup> US Senate Permanent Subcommittee on Investigations, “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,” April 13, 2011.

<sup>11</sup> Wall Street Journal, “Dual Role in Housing Deals Puts Spotlight on Deutsche,” August 3, 2010.

<sup>12</sup> Wall Street Journal, “Deutsche Bank Loses Swaps Case,” March 23, 2011.

<sup>13</sup> Ibid.

<sup>14</sup> Public comment letter submitted to the CFTC and SEC by Barclays Bank PLC, BNP Paribas SA, Deutsche Bank AG, Royal Bank of Canada, Royal Bank of Scotland, Societe Generale, UBS AG, “Re: Application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act to Foreign Banks’ Global Swaps Businesses,” January 11, 2011. *Emphasis added.*

<sup>15</sup> Public comment letter submitted to the CFTC by Futures Industry Association, International Swaps and Derivatives Association, Securities Industry and Financial Markets Association, “Re: Proposed Commodity Exchange Act Rules 1.71 and 23.605 Re: Implementation of Conflict of Interest Policies and Procedures by Futures Commission Merchants, Introducing Brokers, Swaps Dealers, and Major Swap Participants (RIN 3038-AC96),” January 18, 2011.

As the Deutsche Bank examples make abundantly clear, derivative end-users cannot rely on dealers' "extensive control mechanisms" or "home country rules" to protect them from undisclosed conflicts of interest. Nor should they be forced to rely on SROs. To bring true transparency to this market, the conflict of interest rules need to be monitored and enforced at the Commission level.

We appreciate the opportunity to provide comments to the Commission regarding the Proposed Rule, and we would be pleased to discuss any questions or comments the Commission might have with respect to this letter. I can be reached at (702)387-7069.

Respectfully submitted,

Mukul Kumar  
Research Analyst  
UNITE HERE

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cc: Honorable Gary Gensler, CFTC, Chairman  
Honorable Michael Dunn, CFTC, Commissioner  
Honorable Jill E. Sommers, CFTC, Commissioner  
Honorable Bart Chilton, CFTC, Commissioner  
Honorable Scott O'Malia, CFTC, Commissioner