BETTER MARKETS
TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

February 15, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN: 3038–AD88)

Ladies and Gentlemen:

Better Markets, Inc.[1] appreciates the opportunity to comment on matters identified in the above-captioned proposed rule ("Proposed Rule") of the Commodity Futures Trading Commission ("CFTC"). The Proposed Rule would enhance the protection of customer funds by Futures Commission Merchants ("FCMs") and Derivatives Clearing Organizations ("DCOs") in accordance with the Commodity Exchange Act ("CEA") and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

INTRODUCTION AND SUMMARY

As made abundantly clear by the MF Global crisis in the fall of 2011, DCOs and FCMs must be held to high standards in their treatment and segregation of customer funds. Under the CEA and the Dodd-Frank Act, the CFTC has the authority to promulgate rules regarding permissible uses and handling of customer funds. The Proposed Rule represents the CFTC's exercise of this authority, and it will provide increased protections against the loss or defalcation of customer funds.

This comment letter focuses on the consideration of costs and benefits in the Release. It elaborates on the CFTC's actual statutory duty, addresses industry arguments often made against the CFTC's consideration of costs and benefits, examines the core principles that should govern the CFTC's fulfillment of that duty, and reviews the Proposed Rule in light of those principles.

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[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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In sum, the Release includes an extensive consideration of costs and benefits in light of the applicable statutory factors. Furthermore, the Release articulates some important and appropriate principles that govern the application of Section 15(a) of the CEA.[2] However, the CFTC did not make sufficiently clear and explicit in the Release that: it is only obligated to consider costs and benefits within the limited parameters set forth in Section 15(a); that this duty is fundamentally distinct from the duty to conduct a cost-benefit analysis; and that the CFTC is not obligated on any other ground to conduct a cost-benefit analysis. Moreover, the CFTC did not fully explain the Proposed Rule's connection to the overarching purposes of the CEA and the Dodd-Frank Act, including the enormous benefits of establishing a safer and sounder financial system.

COMMENTS

The statutory standard.

Section 15(a) of the CEA sets forth the CFTC's statutory requirement to "consider" the costs and benefits, as they relate to certain public interest factors, of each discretionary action it takes under its statutory authority. 7 U.S.C. § 19(a). Specifically Section 15(a) directs the agency, when promulgating a rule, to "consider the costs and benefits of the action of the Commission" and to evaluate those costs and benefits "in light of"—

(A) considerations of protection of market participants and the public;

(B) considerations of the efficiency, competitiveness, and financial integrity of futures markets;

(C) considerations of price discovery;

(D) considerations of sound risk management practices; and

(E) other public interest considerations.

The persistent and unfounded criticisms from industry regarding economic analysis.

Even when the CFTC has clearly fulfilled its duty to consider the economic impact of their rules, representatives from industry have challenged proposed rules claiming – without merit – that the CFTC failed to appropriately conduct what the industry calls "cost-benefit analysis."

These attacks rest on a series of fundamentally flawed claims. For example, in challenging rules promulgated by the CFTC, the industry has:

[2] 7 U.S.C. § 19(a).

(1) greatly exaggerated the actual duty imposed on the CFTC by its governing statute, Section 15(a) of the CEA, in effect seeking to transform that limited duty into an "industry cost-only analysis;"

(2) entirely disregarded the paramount statutorily required role of the public interest in the rulemaking process; and

(3) indefensibly ignored the enormous cost of the financial crisis and the larger collective benefit of all rules designed to help prevent a recurrence of that crisis or something far worse.[3]

Core principles that must apply to the CFTC's consideration of costs and benefits.

When analyzing these attempts to undermine financial reform on what industry claims to be cost-benefit grounds, it is vitally important to bear in mind several core principles that accurately define the true nature and scope of the obligation that the CFTC has when considering the economic impact of its rules.

1. *Under the CEA, the CFTC has no statutory duty to conduct cost-benefit analysis; in fact, its far more narrow obligation is simply to consider certain factors related to the public interest.*

Section 15(a) of the CEA imposes a limited obligation on the CFTC simply to "consider" the costs and benefits of its rules in light of five specified public interest factors. [4] It contains no language requiring a cost-benefit analysis and there is no basis for imposing any such requirement (and certainly none for an industry cost-only analysis, which is what the industry is really seeking).

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[3] *See* BETTER MARKETS, THE COST OF THE WALL STREET-CAUSED FINANCIAL 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.

[4] Better Markets has set forth a comprehensive analysis regarding the scope of Section 15(a) in the *amicus curiae* brief it filed in support of the CFTC in *ISDA v. CFTC*, Civil Action No. 11-cv-2146 (RLW) ("*Amicus* Brief") (*available at* http://bettermarkets.com/sites/default/files/Corrected%20Brief%20of%20Better%20Markets%20as%20Amicus%20Curiae%20in%20Support%20of%20Defendant%20CFTC%20Apr.%2030,%202012.pdf). In that case, representatives of industry challenged, *inter alia*, the CFTC's consideration of costs and benefits in connection with the position limits rule. *See also* Better Markets *amicus* Brief filed in another case challenging a different rule, *available at* http://bettermarkets.com/sites/default/files/ICI%20v.%20CFTC%20-%20Amicus%20Brief%20of%20Better%20Markets%20June%2025,%202012.pdf. In addition, Better Markets has written to the Office of Management and Budget ("OMB") opposing CFTC Commissioner Scott O'Malia's request that OMB review the cost-benefit analysis performed by the CFTC in connection with several recently finalized rules. Letter from Better Markets to Jeffrey Zients, Acting Director of OMB (Feb. 29, 2012) ("Letter to OMB"), *available at* http://bettermarkets.com/sites/default/files/O'Malia%20CBA%20letter%20to%20OMB.pdf. In the Letter to OMB, Better Markets makes clear that various executive orders and OMB guidelines requiring cost-benefit analysis are inapplicable to the CFTC's rulemaking. Both *amicus* Briefs and the OMB Letter are incorporated by reference as if fully set forth herein.

Moreover, Congress's careful choice of words in Section 15(a) and the case law construing similar provisions, make clear that the CFTC has broad discretion in discharging its duty. The Supreme Court has long recognized that when statutorily mandated considerations are not "mechanical or self-defining standards," they "imply wide areas of judgment and therefore of discretion" as an agency fulfills its statutory duty.[5]

In fact, the CFTC has no statutory or other obligation to quantify costs or benefits,[6] weigh them against each other,[7] or find that a rule will confer a net benefit before promulgating it. The rationale for this flexible obligation in the law is clear: requiring the CFTC to conduct a resource intensive, time consuming, and inevitably imprecise cost-benefit analysis as a precondition to rulemaking would significantly impair the agency's ability to implement Congress's regulatory objectives. The industry's desire to have its costs prioritized over all other costs (what they falsely refer to as "cost-benefit analysis") does not change the law, the reasoned basis for the law, or the underlying policy.

2. *The CFTC must be guided by the public interest as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.*

The five factors that the CFTC must consider as specified in Section 15(a) reflect Congress's primary concern with the need for regulations that serve the public interest and accomplish the agency's mission, not with a need to spare industry the costs of regulation. Without exception, each factor relates to a public benefit that arises from a robustly regulated marketplace, including preventing abuse, promoting competition, enhancing transparency, and limiting systemic risk.[8]

Tellingly, none of the factors listed in the statute mentions any industry-focused concerns, such as compliance costs or the feasibility of conforming to rule

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5 *Sec'y of Agric. v. Cent. Roig Ref. Co.*, 338 U.S. 604, 611 (1950).

6 *Cf.* 42 U.S.C. § 300g-1(b)(3) (imposing a duty on the Environmental Protection Agency to use analysis of specific factors including the "[q]uantifiable and nonquantifiable health risk reduction benefits," the "[q]uantifiable and nonquantifiable costs," and "[t]he incremental costs and benefits associated with each alternative."). Courts have repeatedly held that an agency need not quantify the costs and benefits of a rule when a statute does not require it. *See, e.g., FMC Corp. v. Train*, 539 F.2d 973, 978-979 (4th Cir. 1976) (finding that 33 U.S.C. §§ 1314(b)(1)(B), (b)(2)(B) and § 1316 do not require quantification of the benefits in monetary terms). In fact, the D.C. Circuit has explicitly recognized that an agency's "predictions or conclusions" do not necessarily need to be "based on a rigorous, quantitative economic analysis." *Am. Fin. Services Ass'n. v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985); *see also Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81, 91 (3d Cir. 1994) (recognizing that "much of a cost-benefit analysis requires predictions and speculation, in any context," and holding that the "absence of quantitative data is not fatal").

7 Courts distinguish statutes which include language of comparison, requiring a cost-benefit analysis, and statutes which do not. *See Am. Textile Mfrs. Inst. v. Donovan*, 452 U.S. 490, 512 n.30 (1981); *Reynolds Metal Co. v. EPA*, 760 F.2d 549, 565 (4th Cir. 1985); *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1045 (D.C. Cir. 1978).

8 7 U.S.C. § 19(a)(2).

requirements.[9] Removing any doubt, the fifth and final factor in Section 15(a) requires the CFTC to consider generally "any **other public interest** considerations."[10]

3. The CFTC need not consider the costs and benefits associated with mandatory rulemakings.

It is also clear from the statute that the CFTC's obligation to consider costs and benefits applies only to the discretionary component of rulemaking. Not only is it unnecessary under the statute for the CFTC to consider the costs and benefits of actions mandated by Congress, it would also be fruitless for the agency to do so, since the agency has no authority to second-guess, ignore, or countermand the directives of Congress on cost-benefit or any other grounds.

Indeed, by mandating a rulemaking, Congress necessarily has already weighed the costs and benefits and the agency's role is simply to implement Congress's directive. To construe a statute otherwise would make it impossible for Congress to mandate a rulemaking because all such rules would nonetheless be subject to some form of economic or cost-benefit analysis by an agency and then, almost assuredly, by a court. That would violate the constitutional principles of separation of powers, subordinating Congress's legal powers to both the agencies, which are the very creatures created by Congress to carry out its directives, and the courts.

4. For any rule promulgated in accordance with and in furtherance of the Dodd-Frank Act, the ultimate "public interest consideration" is implementing the reforms that Congress passed to provide for a safer and sounder financial system and to prevent another financial crisis.

The statutory authority for the Proposed Rule is derived in part from the CEA and in part from the Dodd-Frank Act. The CFTC must therefore consider the costs and benefits of the Proposed Rule in light of the goals of both statutes, giving proper weight to Congress's overriding objectives. With respect to the Proposed Rule, the broader benefits of improved customer fund protection must be taken into account, not merely the important but narrow benefits to the investors whose money is now better protected. These benefits include increased investor confidence in market participants and a reduced risk of market participant collapse with systemic implications.

In addition, the CFTC must consider the larger objective of the Dodd-Frank Act: to dramatically improve FCM and DCO business practices, and to institute a

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[9] *Cf.* 42 U.S.C. § 300g-1(b)(3)(C) (requiring analysis of certain costs of safe drinking water regulations including costs that "are likely to occur solely as a result of compliance with the maximum contaminant level, including monitoring, treatment, and other costs"); 42 U.S.C. § 6295(d) (1976 ed., Supp. II) (requiring a weighing of the economic impact on manufacturers and the savings in operating costs as "compared to any increase in the price of, or in the initial charges for, or maintenance expenses of, the covered products which are likely to result").

[10] 7 U.S.C. § 19(a)(2)(E) (emphasis added).

comprehensive set of reforms, including a regime for regulating swaps, to prevent another financial collapse and economic crisis, including trillions of dollars in financial losses and incalculable human suffering.

The dollar cost alone of the financial collapse and still-unfolding economic crisis is conservatively estimated to be in the trillions. A study by Better Markets estimates that those costs will exceed $12.8 trillion.[11] In addition, the Government Accountability Office has just issued the results of a study on the costs of the crisis, finding that "the present value of cumulative output losses [from the crisis] could exceed $13 trillion."[12] Therefore, as the CFTC assesses the costs and benefits of proposed rules under Section 15(a), it must continue to consider, above all, the benefits of the entire collection of reforms embodied in the Dodd-Frank Act, of which any specific rule is but a single, integral part.

5. *Congress's resolve to prevent another massively costly financial crisis clearly overrides any industry-claimed cost concerns under the Dodd-Frank Act.*

Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis. Those costs include the elimination of extremely profitable lines of business as well as significant and ongoing compliance costs. A leading example is the establishment of the new, comprehensive regulatory regime for swaps. It will require the financial industry to incur significant costs arising from new personnel and technology, ongoing compliance, margin and collateral, and reduced revenues and profits.

However, the financial reform law and the rules implementing it do not, in fact, add any incremental costs (or, if they do, those costs are *de minimis*). Rather, they reallocate costs so that industry bears them in a regulated environment that **prevents** financial failure and bailouts. As a result, the public and society are spared the massive costs of responding to economic crises after the fact.[13]

Congress fully understood this. It knew that re-regulation would impose costs on the industry, in some cases totaling billions of dollars. The Dodd-Frank Act reflects Congress's unflinching determination to shift the costs of de-regulation and non-regulation of the financial industry back to the industry from a society that has paid and continues to pay the bill for industry's unregulated excesses. In substance, Congress conducted its own cost-benefit analysis and concluded that the enormous collective

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11 *See* Report, *supra* note 10.

12 U.S. GOVERNMENT ACCOUNTABILITY OFFICE, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT, GAO-13-180, at 17 (Jan. 2013) (released Feb. 14, 2013), *available at* http://gao.gov/assets/660/651322.pdf.

13 *See* BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC, at 39-44 (July 30, 2012), *available at* http://bettermarkets.com/sites/default/files/CBA%20Report.pdf.

benefits of the law far exceeded the costs and lost profits that industry would have to absorb.[14]

Against the backdrop of the worst financial and economic crises since the Great Depression, it is inconceivable that Congress would enact sweeping reforms and then allow the implementation of those reforms to hinge on the outcome of a biased cost-benefit analysis that ignored the overriding purpose of the new regulatory framework—and that gave controlling weight to cost concerns from the very industry that precipitated the crisis and inflicted trillions of dollars in financial damage and human suffering across the country.

Indeed, had Congress wanted the financial regulatory agencies to conduct cost-benefit analysis prior to promulgating the rules under the Dodd-Frank Act, it would have clearly said so. Congress passed the Dodd-Frank Act fully aware of the specific economic analysis provisions in the federal agencies' governing statutes—like Section 15 of the CEA—and fully aware of how to impose a cost-benefit analysis requirement. Yet, it made no changes to those provisions, thereby affirming congressional intent that those specific provisions should control as they were originally written and intended.

In short, the following analytical framework must guide any consideration of the economic impact of rules implementing the Dodd-Frank Act, or any rules that are promulgated within the broader Dodd-Frank Act context:

- Congress's ultimate objective in the Dodd-Frank Act was to prevent another crisis and the massive costs it would inflict to our financial system, taxpayers, investors, economy, and country;
- The Proposed Rule is an integral component of the overall body of reforms that Congress envisaged to achieve this objective; and
- The costs of compliance and reduced profits that industry may have to absorb by virtue of the Proposed Rule, as well as the entire Dodd-Frank Act, were considered by Congress in passing the law and determined to pale in comparison with the benefits of preventing another crisis—a benefit that can be valued at over $12.8 trillion.

<u>The Application of Section 15(a) in the Release.</u>

The Release shows that the CFTC has considered the economic impact of the Customer Funds Rule under Section 15(a). However, the CFTC must also make clear that its consideration of the Rule's costs and benefits need not extend beyond the agency's narrow statutory duty under Section 15(a). Further, the CFTC must fully explain the

[14] *Id.* at 43.

Rule's connection to the purposes of the Dodd-Frank Act and the larger benefits of establishing a safer and sounder financial system.

1. The CFTC complied with Section 15(a).

The CFTC's Consideration of Costs and Benefits section is very detailed, spanning 30 pages.[15] It shows clearly that the CFTC complied with the statutory standard, considering costs and benefits for each public interest factor that is relevant.

The section begins with an acknowledgment that the consideration need only be conducted for the discretionary component of the CFTC's rulemaking.[16] This confirms that where Congress mandates a rule, the agency is not obligated to consider those mandatory costs and benefits.

Next the CFTC appropriately identifies the "four considerations relevant to this proposal:" (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) sound risk management practices; and (4) other public interest considerations—and provides a brief, yet comprehensive overview of those considerations.[17] It also reasonably acknowledges that the statutory factors it considers are the "15(a) public interest, cost-benefit considerations."[18]

The Release also seeks data from commenters as to certain aspects of the Rule. Although the agency is not required to quantify the Rule's costs or benefits or conduct its own study, this request is appropriate to enable the CFTC to evaluate some commenters' claims about the costs or benefits. Indeed, industry often attacks an agency's consideration of costs and benefits, asserting that the rule would impose debilitating costs, but then fails or refuses to provide any meaningful data or information. In such cases, the agency should appropriately discount, if not disregard entirely, these unsupported claims.

2. The CFTC must ensure that its economic consideration is limited to its narrow duty under Section 15(a).

The CFTC should carefully avoid undertaking a cost-benefit analysis, or any similar approach in which agencies determine and quantify costs and benefits, net them against one another, and adopt the least costly rule. This type of analysis is not required by Section 15(a), it poses a threat to the implementation of Congress's policy goals, and it wastes agencies' resources without producing accurate or useful results. At a minimum, the CFTC should, in explaining its statutory duty under Section 15(a), "assert that it is not required" to perform a cost-benefit analysis, quantify or compare costs and

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15 Release at 67,898-928.
16 Release at 67,899.
17 The Release notes that the amendments would not have any effect on price discovery, the fifth public interest consideration. Release at 67,899.
18 Release at 67,902.

benefits, or perform any analysis that exceeds the Section 15(a)'s requirements.[19] Although in the Release, the agency scrupulously avoids any suggestion that it must balance quantified costs and benefits or find that one outweighs the other before promulgating a rule, the CFTC should make this explicit. In addition, as mentioned above, there is no need for the agency to quantify or "determine" the Rules costs and benefits.

Moreover, in the bulk of the Consideration of Costs and Benefits section of the Release, the CFTC details the specific 15(a) considerations as they relate to each proposed change. While those sections are comprehensive, it is often unclear how certain considerations relate to the five public interest considerations in the statute. To the extent that some of the costs and benefit identified by the agencies do not relate to the five factors, the agency should not include them in the analysis.

3. The CFTC should more clearly set forth the connection between the particular proposed rule and the comprehensive, integrated law of which it is part

The context in which the Proposed Rule is being promulgated, concurrently with an overhaul of other FCM and DCO market practices under the Dodd-Frank Act, is extremely important and should have been more fully explained in connection with the consideration of the application of Section 15(a). Although the agency, citing specific examples, appropriately acknowledged that "[r]ecent events demonstrate the need for revisions to the CFTC's customer protection regime," it failed to also particularly set forth that the Rule was being proposed and promulgated in part in accordance with and in furtherance of the entire Dodd-Frank Act, although this was obviously the case.[20]

This level of detail is appropriate to illustrate the larger interests at stake: not only protecting customer funds, but increasing confidence in the markets, reducing the risk of failure among market participants that can spread throughout a market, and ultimately reducing the likelihood of a future financial collapse and economic crisis.

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[19] *American Equity Investment Life Insurance Co. v. SEC*, 613 F.3d 166, 177 (D.C. Cir. 2010) (noting that the "SEC conducted a [efficiency, competition, and capital formation] analysis when it issued the rule with no assertion that it was not required to do so.").

[20] *See* Release at 67,866, 67,868 & 67,902 (citing the Rule components based upon authority conferred by the Dodd-Frank Act).

CONCLUSION

We hope these comments are helpful as you finalize the Proposed Rule.

Sincerely,

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