June 24, 2013

BY HAND DELIVERY

The Honorable Mark Wetjen
Commissioner
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Commissioner Wetjen,

The regulation of cross border derivatives activities currently hangs in the balance, with the CFTC reportedly deadlocked at 2-2 and with you largely undecided. Therefore, I thought it might be helpful to summarize our responses to the key issues you have raised and which we discussed at our recent meeting on this extraordinarily important issue.

As you know, our view is that, after 2 ½ years of consideration, there are simply no valid reasons for the CFTC to delay yet again finalizing its cross border guidance by July 12, 2013 and making it as strong as possible to protect the American people from having to bail out the global financial system again.

SUMMARY OF RESPONSES

1. The recently proposed SEC rule on cross border is—

    a. inapplicable to the CFTC's statutory mandate to regulate cross border transactions with a "direct and significant" connection to the United States;

    b. very weak regarding the issue it does cover, i.e., anti-evasion; and

    c. grossly deficient in its approach to "substituted compliance" and will almost certainly ignite a global race to the regulatory bottom, exposing U.S. taxpayers to unacceptably high risks of having to bail out Wall Street again.

2. As a recent study by the CFTC demonstrated, there are **no** current conflicts between the CFTC cross border guidance and any international laws, rules or regulations;

3. It will take years for foreign governments and regulators to catch up to the U.S. on comprehensive derivatives regulation—if in fact they ever do adopt and implement

truly comparable regulations—and waiting for them before protecting U.S. taxpayers and the treasury is unjustifiable;

4. Substituted compliance, if it is used at all, must be comparable in form, substance, enforcement and over time on a rule-by-rule basis and not an excuse to outsource the protection of the American people,

    - especially to foreign regulators who have a record of repeatedly failing to protect their own depositors, taxpayers and treasuries; and

5. Cross border derivatives blow-ups and the financial crisis have already cost the U.S. trillions of dollars and an enormous amount of suffering, and it must be prevented from happening again, which strong cross border regulation will help to do.

The Recently Proposed SEC Rule is Inapplicable to the CFTC, Very Weak and No Basis for Further Delay

The SEC's Proposed Rule is based on fundamentally different legal authority

The SEC was given very limited statutory authority in the Dodd-Frank Act related solely to anti-evasion and no mandate at all regarding cross border jurisdiction, as we set forth in the recent Power Point presentation to you and your staff, a copy of which is attached here for reference.[1] In stark and clear contrast, the CFTC was given the same anti-evasion authority **plus** an affirmative statutory mandate to regulate cross border derivatives activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States." (Compare DFA Section 772 (b) [SEC] with Section 722(d) [CFTC]).

Thus, the SEC proposed rule is **entirely inapplicable** to the CFTC's statutory mandate to regulate the risks from cross border derivatives trading and related activities (as distinguished from their shared desire to prevent evasion).

This strong statutory mandate to the CFTC makes sense, of course, because the dark, unregulated derivatives markets was where the last financial crisis was invisibly incubated, grew exponentially and acted as a conveyor belt to transmit the crisis throughout the globe.

The SEC oversees a tiny segment of the derivatives market

The CFTC's broader statutory mandate also makes sense because the CFTC has decades of expertise and jurisdiction for virtually the entire derivatives markets. Indeed, the SEC has jurisdiction for no more than 3.5 percent of those markets.

[1] Attached is the same presentation we used in our meeting with you other than the clarification on slide 18, which we discussed, and the elaboration of the European process on slides 22-24.

The CFTC has jurisdiction for more than 96.5 percent of the combined swaps and security-backed-swaps markets,[2] in addition to the unique, broad statutory mandate. To think that the CFTC should follow or be influenced by the SEC's recently proposed rule under such circumstances is nonsensical (or perhaps pretextual). It would be as if the SEC deferred to the CFTC to set the regulatory standards for all mutual funds simply because the CFTC required less than 1 percent of mutual funds to also register as a CPO. That would never happen, of course, and it should not be permitted in connection with cross border derivatives regulation.

The CFTC has fully considered its cross border guidance for 2 ½ years, while the SEC is just beginning

It would be irresponsible for the CFTC to wait for the SEC, even as to its very limited anti-evasion provisions.

As you know, the SEC just proposed a rule regarding the anti-evasion cross border provisions on May 1, 2013. Comments are not even due for months, until August 22, 2013. Moreover, given the sprawling 650 page proposal, an extension substantially beyond that deadline is likely.

In contrast, the CFTC has had 2 ½ years of meetings, consideration, deliberation and virtually unlimited input from industry and others. Indeed, the CFTC worked for 1 ½ years before proposing its initial guidance in June 2012 and then worked for another 6 months before issuing further guidance in December 2012. At the same time that it issued the further guidance in December 2012, the CFTC also issued an exemptive order, pushing back the effective date for yet another seven months, to July 12, 2013. The CFTC has received and considered at least 322 filed comment letters and had dozens of meetings.

Thus, the CFTC has thoroughly considered the cross border guidance and has already delayed its effective date multiple times. The time for delay is over.

The SEC's Proposed Rule is weak

Better Markets will comprehensively comment on the SEC's proposed rule in due course. However, even a cursory glance reveals it to be weak and grossly insufficient to protect the American people, even as to the limited requirement of preventing evasion regarding the 3.5 percent of the market relating to security-based swaps. Indeed, the proposal, unless strengthened, will sound the starting gun for a global race to the bottom regarding cross border derivatives regulation.

For example, the release discusses the need to focus on **risk**, but then proposes a rule focused on the **form** of entities, making regulatory arbitrage relatively easy. This is

[2] BIS Annual derivatives market report, 2012. If either DTCC or CFTC-reported data were used, the SEC portion of the markets would decrease to less than 3 percent. *See*, e.g. http://dtcc.com/products/derivserv/data/index.php.

illustrated, for instance, by the fact that it recognizes risk from the activities of overseas guaranteed affiliates, but then excludes them from the definition of "U.S. person." Frankly, by elevating form over substance, the proposal serves as nothing more than an invitation for regulatory arbitrage.

Troublingly, the SEC proposed rule allows broad, almost unlimited substituted compliance—without any real legal justification[3]—which would be based on a so-called "holistic" approach and purportedly comparable "outcomes." Yet, it proposes only four broad categories to evaluate substituted compliance, which will fail to ensure that foreign regulators protect the American people. The SEC proposal also considers irrelevant factors not in the statute, proposes a process that lacks transparency, and fails to ensure public notice or input.

No Current Conflicts with International Laws and No Delay for the World to Catch Up is Justifiable

There is no current conflict with international laws regarding Title VII. That is largely because the United States in general and the CFTC in particular are years ahead of foreign governments and regulators in passing laws and regulations comprehensively governing derivatives.

To now stop the process and wait for the world to catch up would be indefensible. Now is the time for the CFTC to finalize its cross border guidance, triggering a regulatory race-to-the-top to protect the people of the United States and the globe from another derivatives-ignited financial disaster.

As we understand it, the CFTC's office of the general counsel performed a comprehensive review of derivatives laws in Europe and elsewhere ("Review"). That Review identified no conflicts with Title VII or CFTC regulations. We have been informed that the Review was shared with the European Commission (and presumably other foreign regulators), who confirmed the absence of any conflicts. In addition, we have learned that the Review (which we have not seen) was shared with several prominent Wall Street derivatives dealer banks and their expert representatives and that they too agreed with the Review's conclusion that there were no conflicts.

The fact that others have not yet passed comprehensive laws or implemented regulations means that the field is open for the U.S. to continue to lead the way. Let others follow, ideally with equally strong or stronger rules. If there are conflicts later, then the CFTC can address them later. All such claims of conflicts now are hypothetical and speculative, and they do not constitute a legitimate basis for policy making (or for any delay in making policy).

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[3] The term "substituted compliance" does not appear anywhere within the Dodd-Frank Act, the Securities Exchange Act, or any other potentially applicable law.

In particular, the claims and complaints of European governments, regulators and dealer banks are without merit. While the European Markets and Infrastructure Regulation ("EMIR") has been passed, it has not yet been implemented. Furthermore, it addresses only a limited set of regulations, which deal only with clearing and data reporting. Comprehensive Dodd-Frank Title VII-like regulation in the European Union is still years away. MiFID2 and MiFIR, which govern execution, trading, position limits and other issues, will not be finalized for years. Thus, while your position is that the December 2012 exemptive order, scheduled to expire on July 12, 2013, was set so that the EMIR regulation could be finalized, that is not a proper basis to continue to delay.

As detailed in the attached Power Point and in our response to Michel Barnier's recent incomplete and misleading Op Ed in Bloomberg View,[4] Europe has years to go and many hurdles to overcome in a convoluted process that has many parties pulling in many different directions.[5] To us, it would be irrational and indefensible to condition the protection of the American people on those actions, which will only be final at some indeterminate time in the future.

Because Foreign Regulators Have Failed Repeatedly to Protect their Own Taxpayers, Depositors and Treasuries, Outsourcing the Protection of the American People to Them via Substituted Compliance Must Be Carefully Limited (If Used at All)

If substituted compliance is to be used, foreign laws and regulations must be comparable in form, substance, enforcement and over time. Moreover, they must be evaluated on a rule-by-rule basis. Substituted compliance cannot be viewed "holistically" and based on broad, purportedly comparable outcomes or it will become an invitation for regulatory arbitrage.

Moreover, no one should be comforted by anyone's claim that foreign regulators can and will protect American taxpayers. Foreign regulators, and European regulators in particular, failed miserably to protect their own depositors, taxpayers and treasuries. The banks that were nationalized in Europe, many exceeding the GDP of the entire country, have saddled their taxpayers with trillions of dollars in liabilities. Moreover, foreign regulators have a conflict of interest in enforcing strong rules against U.S. derivatives dealers. If they have weaker rules, laws or enforcement, then U.S. firms will move their business, jobs and revenues overseas, while the bill for

4 Compare "U.S. Can't Go It Alone on Derivatives" (Barnier) with "European Attacks on U.S. Regulators Must Not be allowed to Weaken U.S. Derivatives Rules" (Kelleher): http://www.bloomberg.com/news/2013-06-20/u-s-can-t-go-it-alone-on-derivatives.html with http://www.huffingtonpost.com/dennis-m-kelleher/european-attacks-on-us-regulators_b_3480021.html .

5 *See*, e.g., "Hard Bargaining starts on MiFID2," Financial Times, Philip Stafford, June 18, 2013 (*available at* http://www.ft.com/intl/cms/s/0/9c774aee-d800-11e2-9495-00144feab7de.html#axzz2X5r5Nt2D).

their recklessness will be sent back to the U.S., as it was in the cases of AIG, Lehman Brothers, Citigroup, Bear Stearns and so many others.

This is undoubtedly why the Federal Reserve Bank has rejected substituted compliance for foreign banks operating in the U.S.[6] Pre-crisis, it relied on the home countries' regulators to supervise the U.S. operations of foreign banks. The crisis proved that to be a total failure and now, post-crisis, the Fed is requiring foreign bank organizations in the U.S. to set up intermediate holding companies which must adhere to Fed rules applicable to domestic banks.

Cross Border Derivatives Activities Have Already Cost the United States an Enormous Amount

The cross border activities of global derivatives dealers have already cost the United States an enormous amount. The frequently-cited examples of this from the 2008 crisis include Bear Stearns (Cayman affiliates operating in New York with swaps desks in London), Lehman Brothers (swaps book run out of London), AIG Financial Products (French affiliate operating in London) and Citigroup (Cayman affiliates operating in London). Two examples that demonstrate that cross border risks return to the United States, even if they don't cost taxpayers directly, are the JP Morgan Chase "London Whale" loss (London branch) and the Long Term Capital Management collapse (Cayman affiliates operated in London).

But that's not all. The U.S. had to bail out the global financial system in general and foreign banks and dealers in particular. For example, of the 22 AIG counterparties bailed out by the U.S. government, 17 were foreign banks. Of the 20 largest users of Federal Reserve Bank's emergency lending facilities, nine were foreign banks. Also, the Fed pumped $1.9 trillion into foreign swap lines in the 30 days after the collapse of Lehman Brothers and $5.4 trillion in the 90 days after its collapse.

Protecting the American people from the devastation of another financial crisis and another long list of costly bailouts is what is at stake in the cross border guidance. It should be done without delay and in as protective a way as necessary. The American people deserve no less.

[6] *See* Federal Reserve Board of Governors Proposed Rule "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Regulation YY, Docket Number 1438, RIN 7100 AD 86)" *available at* http://www.stlouisfed.org/regreformrules/Pdfs/2012-12-28_FRS_proposed_enhanced_standards_foreign_organizations.pdf.

The Costs to the United States of the Last Financial Crisis Have Been Staggering and Must be Prevented from Happening Again

Too much of the financial reform discussion is antiseptic, academic, bloodless and ahistorical. Regulators, lobbyists, lawyers and other Wall Street allies all focus on each rule as if it were an end in itself. The purpose of a rule, its connection to comprehensive regulation and reform, and the financial and economic crises giving rise to it are never mentioned by those importuning the CFTC to write rules that protect their business lines and profits. While they always talk of liquidity, working markets, growth, etc., never forget that those ostensible concerns always happen to coincide with their economic interests. Healthy skepticism about their claimed magnanimous concerns is vital if the real public interest is to be served.

The financial crash of 2008 was the worst financial collapse since 1929 and it ushered in the worst economy since the Great Depression. The ongoing costs of those historic events to the people, communities and government of the United States will be more than $12.8 trillion over ten years (not including the costs of the Fed's zero interest rate policy and asset purchases, all of which have been necessitated by the massive damage done by the financial collapse). [7]

Of course, the dollar cost, almost unimaginably large, will still never capture the human suffering and economic wreckage inflicted on our country from coast to coast by the financial and economic crises. Financial reform in general and Title VII in particular were passed to prevent that from happening again. The regulation of cross border derivatives trading and activities that have a direct and significant effect on the U.S. are an essential part of that framework.

CONCLUSION

As we have made clear in our several comment letters,[8] strong cross border guidance is vital not just to derivatives reform and Title VII, but to all of financial reform and the implementation of the Dodd-Frank Act. While the rulemaking process tends to silo discussions on a rule-by-rule basis, Congress didn't pass a law merely directing that

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7 *See* BETTER MARKETS, THE COST OF THE WALL STREET 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.

8 "Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)" (August 16, 2012) *available at* http://bettermarkets.com/sites/default/files/CFTC-CL-%20Cross%20Border%20Delay-%208-16-12.pdf; "Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)" (August 27, 2012) *available at* http://www.bettermarkets.com/sites/default/files/CFTC-%20CL-%20Cross%20Border%20Application%20of%20swaps%20provisions%208-27-12.pdf; and "Proposed Further Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD85)" (February 15, 2013) *available at* http://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Cross-Border%20further%20guidance-%202-15-13.pdf, incorporated here as if fully set forth.

a number of isolated, discrete rules be passed. It enacted broad, comprehensive financial reform as an integrated whole with layers of inter-related protections and this rule must be considered in that context.

After 2 ½ years of consideration, and massive and unlimited input from Wall Street and others, it is time for the CFTC to protect the American people from high risk cross border derivatives trading that has a direct and significant impact on the U.S. We hope this information is helpful to you in coming to the same conclusion.

Sincerely,

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CC: The Honorable Gary Gensler, Chairman
The Honorable Scott D. O'Malia, Commissioner
The Honorable Jill Sommers, Commissioner
The Honorable Bart Chilton, Commissioner

Cross-border Derivatives Regulation

Better Markets' Summary Presentation

June 21, 2013

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Coming to a **U.S.** City Near You? The Cost of the CFTC Not Getting Cross Border Right

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Essential to Protect the American People, Financial System, Economy

- Derivatives market was where the last crisis
  - Was invisibly incubated
  - Ignited the financial crisis
  - Acted as a conveyor belt to transmit the crisis throughout the globe
  - Cost trillions of dollars of losses
- That's why the CFTC was given the **statutory mandate** to regulate cross border derivatives activities

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Costs to U.S. have been staggering

- Too much of financial reform discussion is antiseptic, academic, bloodless & historical
- Financial reform necessary because
  - **Worst** financial collapse since 1929
  - **Worst** economy since the Great Depression
  - Report: Going to **cost the U.S. $12.8+ trillion**
- Money, however, tells only part of the story of lives, families, communities suffering from coast to coast

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THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION

A Report From

BETTER MARKETS
TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

September 15, 2012

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That's not even close to all the costs

- Doesn't include all fiscal policy costs:
  - Much of annual $1 trillion deficits due to increased expenditures and decreased tax receipts from the financial & economic crises
    - Most of discussion about budget cuts due to those costs
- Doesn't include monetary policy & QE costs:
  - Unprecedented zero interest rate policy (ZIRP) AND
  - Unprecedented asset purchases resulting in a $3+ trillion Fed balance sheet
- All necessitated by the financial collapse & economic crisis it caused

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SEC Proposed Rule is Inapplicable to CFTC

- The SEC was given statutory authority limited solely to anti-evasion and no mandate regarding cross border jurisdiction
- The CFTC was given the same anti-evasion authority, but also given an affirmative, expansive statutory mandate to regulate cross border derivatives activities

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SEC Statute:

"(c) Rule of construction. No provision of this title [15 USCS §§ 78a et seq,] that was added by the Wall Street Transparency and Accountability Act of 2010, or any rule or regulation thereunder, **shall apply** to any person insofar as such person transacts a business in security-based swaps **without the jurisdiction of the United States, unless** such person transacts such business in contravention of such rules and regulations as the Commission may prescribe as **necessary or appropriate to prevent the evasion of any provision of this title** [15 USCS §§ 78a et seq,] that was added by the Wall Street Transparency and Accountability Act of 2010…."

Section 772(b) of the DFA

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CFTC Statute:

"(i) Applicability. The provisions of this Act relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act), **shall not apply to activities outside the United States unless** those activities—

(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

(2) contravene such rules or regulations as the Commission may prescribe or promulgate as are **necessary or appropriate to prevent the evasion of any provision of this Act** that was enacted by the Wall Street Transparency and Accountability Act of 2010."

Section 722(d) of the DFA

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Derivatives Market Jurisdiction: CFTC 96.5%, SEC 3.5%

- Of the immense derivatives markets, the SEC has jurisdiction for only the tiny securities based swaps portion of the markets
  - This is, at most, 3.5% of the derivatives market
- The CFTC has jurisdiction for 96.5% of the derivatives market
  - Plus, the CFTC has the expertise & decades of experience with derivatives

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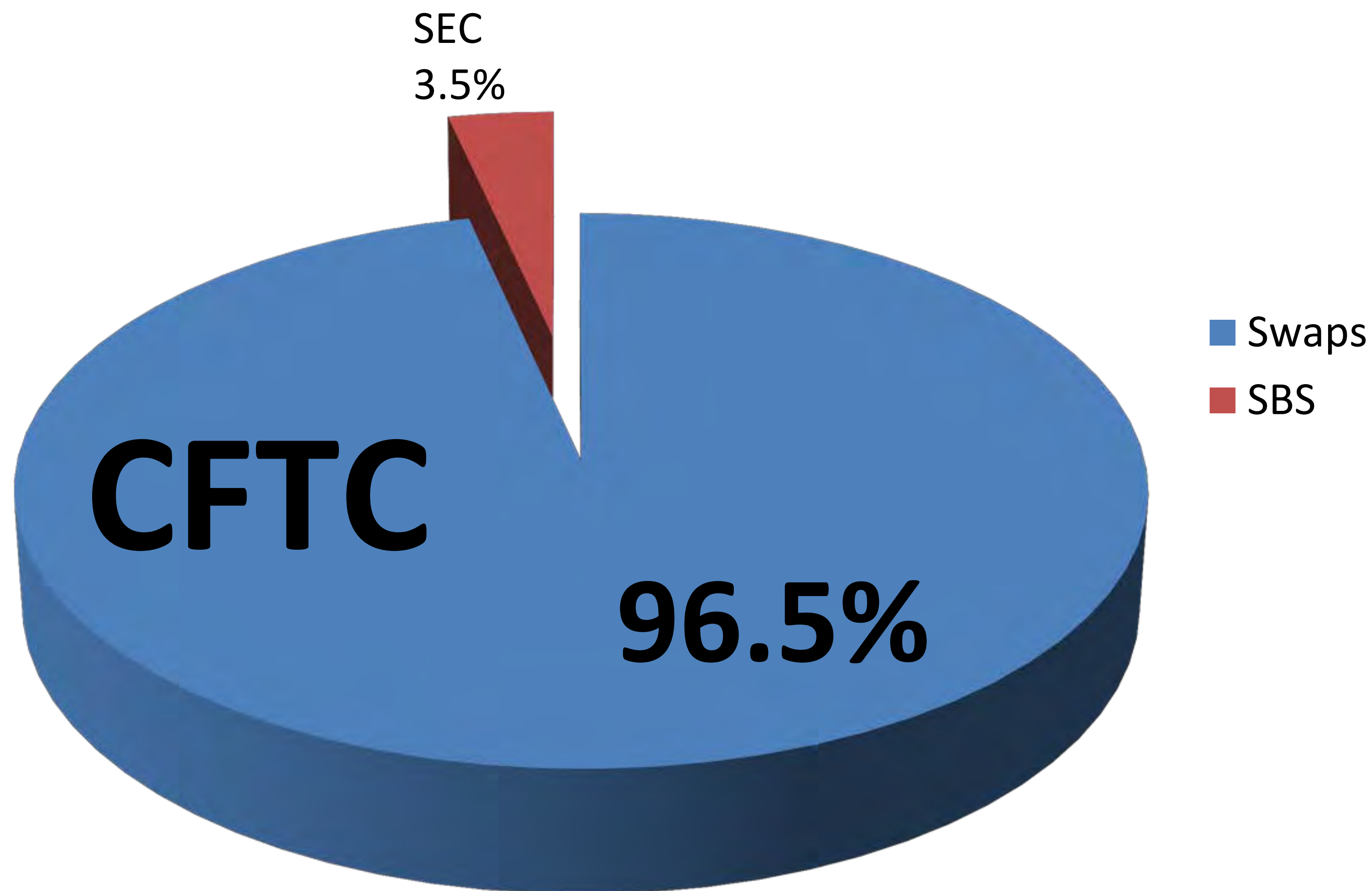
Relative Proportions of Swaps and Security Based Swaps



Source: BIS Annual derivatives market report, 2012. Note, if either DTCC data or CFTC-reported data were used, the SEC portion of the market would be under 3%. Thus, 3.5% is the maximum.

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Turning the World Upside Down

The CFTC following the SEC's views under these circumstances turns the world upside down

- It would be as if CFTC regulations were applied to 100% of mutual funds because less than 1% of mutual funds are also regulated by the CFTC as CPOs
  - Never happen
    - Shouldn't happen
    - With cross border or anything else

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CFTC Should **Not** Wait for the SEC

- It would be irresponsible for CFTC to wait for the SEC
- SEC at very beginning of their regulatory process
  - Just proposed a rule on May 1, 2013
    - Not even any substantive comments yet
- CFTC has been working on cross border for
    - 2 ½ years, beginning before January 2011
    - Proposed guidance June 2012
      - » After 1 ½ years of deliberation, including huge industry input
    - After yet more consideration, further guidance in Dec. 2012
    - After even more input, latest draft circulated May 16, 2013
    - Deadline of July 12, 2013 set 7 months ago
    - Already too many delays

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SEC Proposed rule is weak & will be ineffective in achieving CFTC legal mandate

- The SEC proposal will almost certainly be the starting gun for a global race to the bottom
  - Talks a lot about focusing on risk, but the rule itself focuses on the form of entities, making arbitrage relatively easy
  - Recognizes risk from guaranteed affiliates, but then excludes them
  - Takes a territorial approach, but allows substituted compliance even within the territorial United States (as to external bus conduct standards)

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SEC Substituted Compliance is weak, nontransparent, fails to protect the U.S. & invites regulatory arbitrage

- SC not in DFA & of questionable legal basis
- SEC proposed rule focuses on so-called "holistic" approach to regulation and purportedly comparable "outcomes," but in only 4 overly broad categories
- SEC proposes to consider irrelevant factors not in the statute & which will put the U.S. at risk
- SEC proposes a process that lacks transparency & fails to ensure public notice or input

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Federal Reserve Bank rejecting failed substituted compliance

- Pre-crisis regulation in the U.S. of foreign bank subsidiaries and branches largely left to home country regulation
- Financial crisis revealed that to be total failure
- Now, Fed proposed rule on foreign bank organizations (FBOs) requires them to form an intermediate holding company subject to Fed regulations on capital, etc.

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Required harmonization already done

- Congress ensured that the scope did not go beyond U.S. interests by expressly limiting the scope of the law to only certain activities
  - Only duty to "consult & coordinate … **to the extent possible**," which has been done
- **Law clear: consult, not subordinate; then act** to reduce risk to U.S. from cross border activities as mandated by the law

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There are no conflicts with international regulators

- No conflicts b/c no one has passed comprehensive Title VII-like derivatives laws & won't for **years**
- Plus, 3 comprehensive reviews show no current conflicts:
  - CFTC General Counsel's office
  - European Commission
  - Financial industry
- CFTC cannot afford to wait years before acting simply to avoid the **possibility** of future conflicts
  - If they materialize, CFTC & foreign jurisdictions can work them out as they have with Japan re clearing

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CFTC Should **Not** Wait for Foreign Regulators, Rules or Laws

- The CFTC is years ahead of European regulators & the rest of the world
  - To wait would mean that there are **no** meaningful regulations in place protecting the US
- Finalizing cross border **now** would apply CFTC rules only where appropriate
  - Foreign dealers could apply for substituted compliance where appropriate when foreign rules come into existence

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Europe is Years Behind the US

- The EMIR (regulation), which governs clearing and data reporting, was supposed to be effective by now
  - At least one CFTC Commissioner claims that this was the primary/sole reason the December 2012 exemptive order was set to expire July 12, 2013
  - However, EMIR has been delayed – again – and will not become effective until later this year or early next year
    - Assuming no more delays, which isn't guaranteed

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European Title VII-like Comprehensive Derivatives Regulation is 2 to 5 Years Away

- MiFID2/MiFIR, which governs execution, trading, position limits, etc., will not be finalized for years, according to the best estimates currently available
  - EMIR + MiFID2/MiFIR = DFA Title VII-like comprehensive derivatives regulation
- Comprehensive derivatives regulation in Europe might not be in place until as late as 2018

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Europe's Convoluted Process & Timeline

- Europe's process for regulations & laws makes the US look speedy, streamlined & efficient
- There are level 1 and level 2 requirements
  - Level 1 has 3 steps:
    1: the European Commission (EC)
    2: the European Parliament (EP) and European Council (Council) (acting parallel, but independently)
    3: Trialogue negotiations, votes, etc.
  - Level 2: guidance & national implementation
    - However, even once this is "finalized," there are objection periods when the Council & EP may (& do) delay the process further

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EMIR: Where Europe Is & Where It Has to Go

- ESMA (European Securities & Market Authority) finished its level 2 technical requirements for EMIR in late 2012 (the equivalent of a CFTC rulemaking)
- It was then challenged by the EP, but has now been modified and approved
  - Data reporting will begin later this year
  - Clearing is supposed to begin next year (2014) and will be gradually phased in (ideally in 2014 as well)
    - However, no mandatory clearing determination by ESMA has yet been made
- Bottom line is: EMIR should be fully in effect by the end of 2014

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MiFID2: Where Europe Is & Where It Has to Go

- In June 2013, MiFID2/MiFIR was approved by the Council & EP and now moves to Trialogue negotiations
  - The EP, EC & Council now begin the process of negotiating provisions for the final document
  - ESMA is starting in parallel to work on some technical standards, but will need the final text resulting from EP, EC and Council Trialogue negotiations to complete most of them, which have to then be implemented
    - That could (and almost certainly will) take years
- The EMIR trialogue (which was less controversial than the MiFID2/MiFIR trialogue will be) missed several deadlines and took longer than expected
  - It is therefore virtually certain that estimates of the timeline for finalizing MiFID2/MiFIR are too optimistic
- Bottom line: MIFID2/MiFIR will not be in effect until at least 2015 and may not be until 2018

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Cross Border derivatives activities have already cost the U.S. a great deal

- **Shipping jobs, businesses & revenue overseas, but risk & liabilities from foreign operations stay in/come back to the U.S.:**
  - Bear Stearns: Cayman affiliates operating in New York with swaps desk in London
  - Lehman Bros: swaps book run through London (G)*
  - AIGFP: French affiliate operating in London (G)
  - Citigroup: Cayman affiliates operating in London (G)
  - JPMorgan: “London Whale” = ‘nuf said (G)
  - LTCM: Cayman affiliates operated in London

*involved guarantees by U.S. corporate parent or U.S. affiliate

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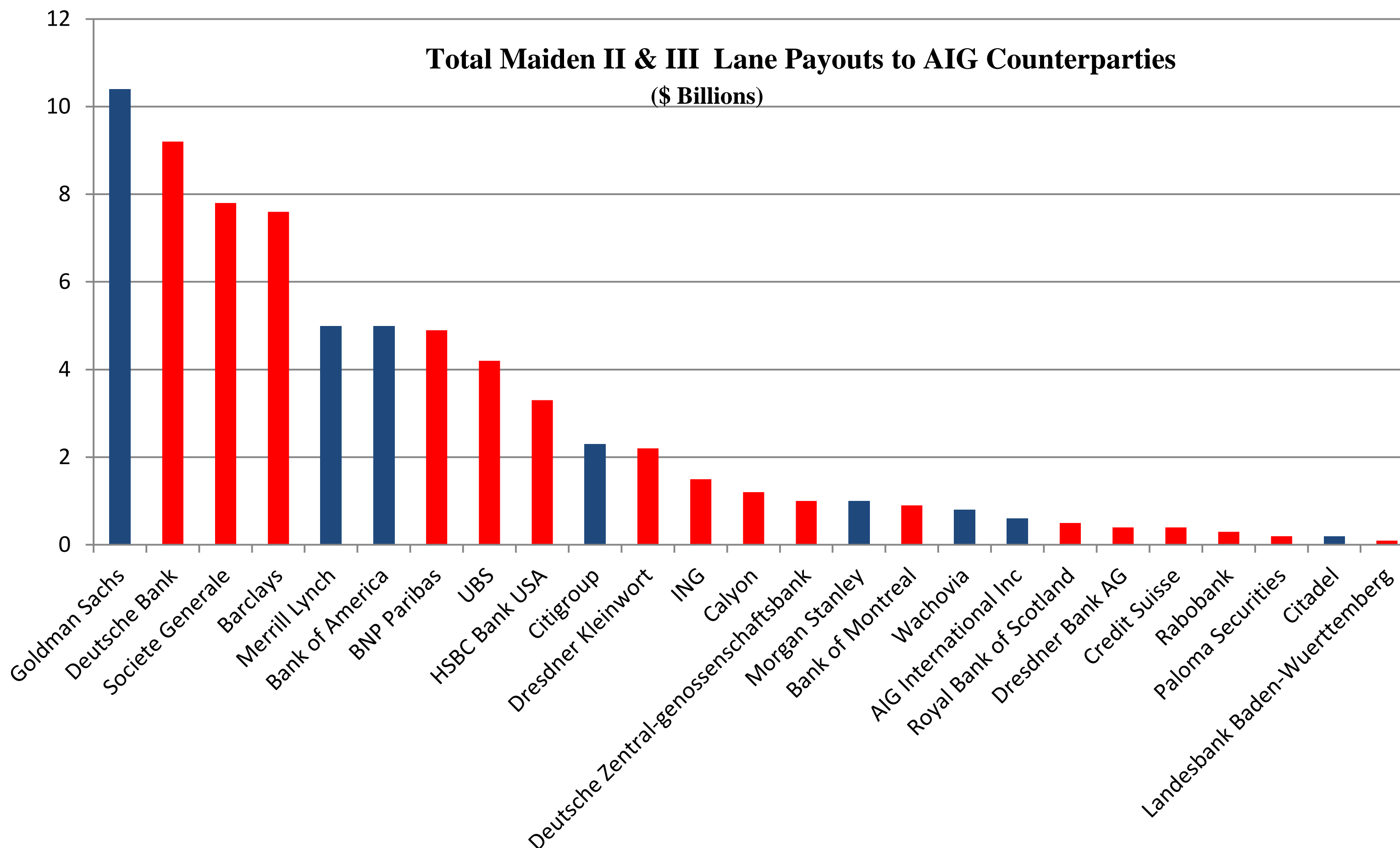
AIGFP risk came home to the U.S.

(blue U.S., red European)



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Not Just AIG: Citigroup

- Citigroup sponsored several Cayman-incorporated SIVs -- essentially small banks funded with commercial paper, with no capital requirements.
- Nominally “bankruptcy remote”, but with implicit support from Citigroup.
- SIV commercial paper was widely held by MMFs.
- In late 2007 Citigroup was forced to take $59B in assets, from 7 SIVs, onto its balance sheet to avoid asset fire sales and reputational loss.
- The associated write-downs reduced the bank’s capital and began a long-term run on the bank

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Not Just AIG: JPMorgan "Whale"

- **London-based JPM** Chief Investment Office made huge, high risk derivatives bets
  - Risk evaluation was manipulated and risk limits were routinely disregarded.
- **NY-based JPM** suffered losses of $6.2+ billion
  - No one in senior management, risk, legal or compliance were aware of the risks or liabilities being assumed by derivatives positions

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Global Dealers Are Disasters Waiting to Happen

- Global dealers are so big and so sprawling, it is only a matter of time before there are more disasters that require more U.S. bailouts
  - Moreover, these global banks operate in so many parts of world, shifting business from one place to another takes but a **keystroke**
- They are structured & staffed **by design** for regulatory arbitrage & today's virtual markets make that easy
- That is why the law requires the CFTC to impose strong, effective cross border regulations

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Dealer Size & Global Scope Make Cross Border Guidance Critical

- U.S. banks' dealer activities truly global
- JPMorgan Chase: world's biggest bank
  - $2.3 trillion in assets U.S. accounting, $3.75 trillion international accounting (conservative numbers)
  - More than 250,000 employees worldwide
  - Operates in more than 60 countries
  - Has thousands of legal entities worldwide
    - Little cost, less time can have legal entities anywhere, doing almost anything

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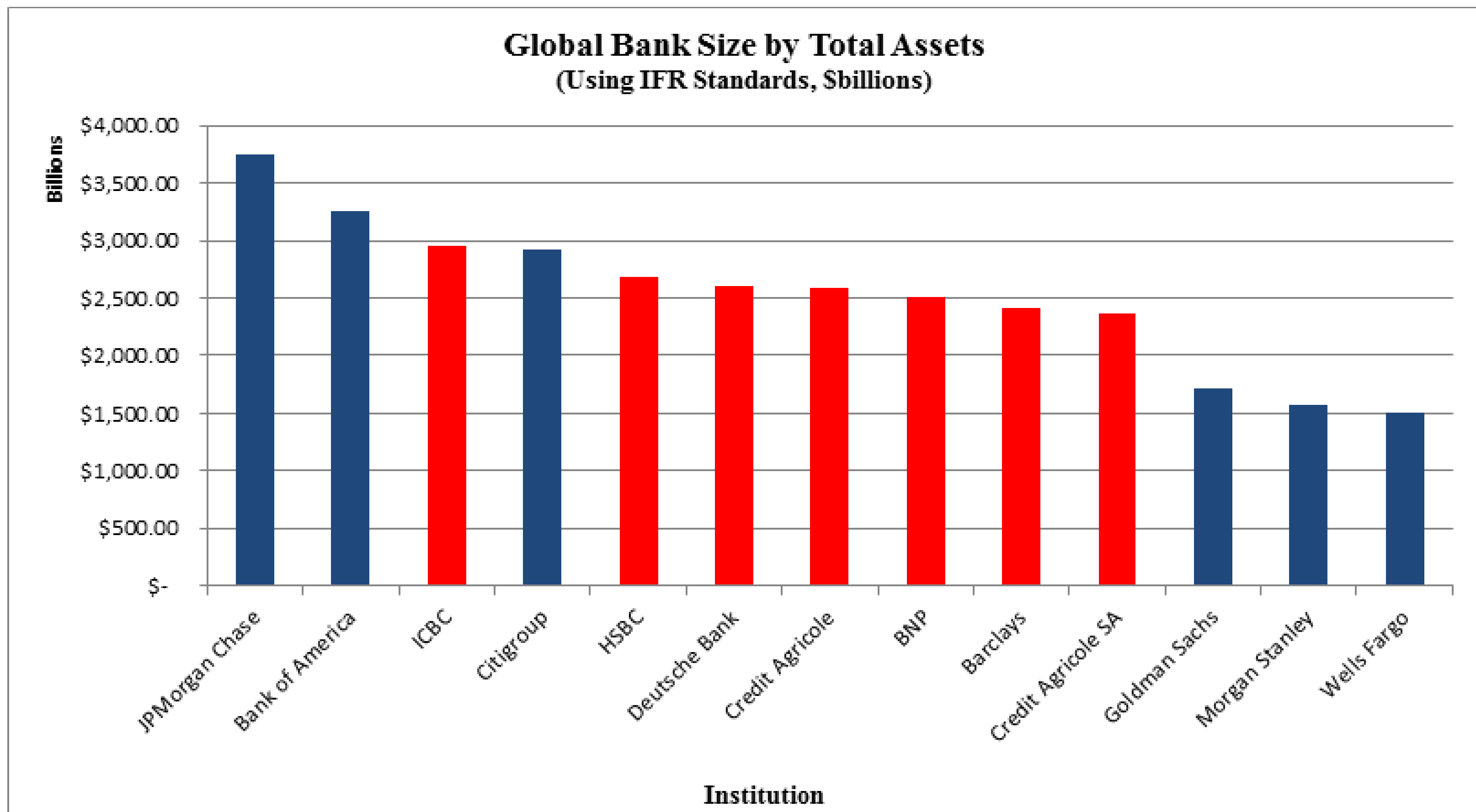
Global Bank Size By Total Assets

Largest banks in the world (blue U.S., red European)



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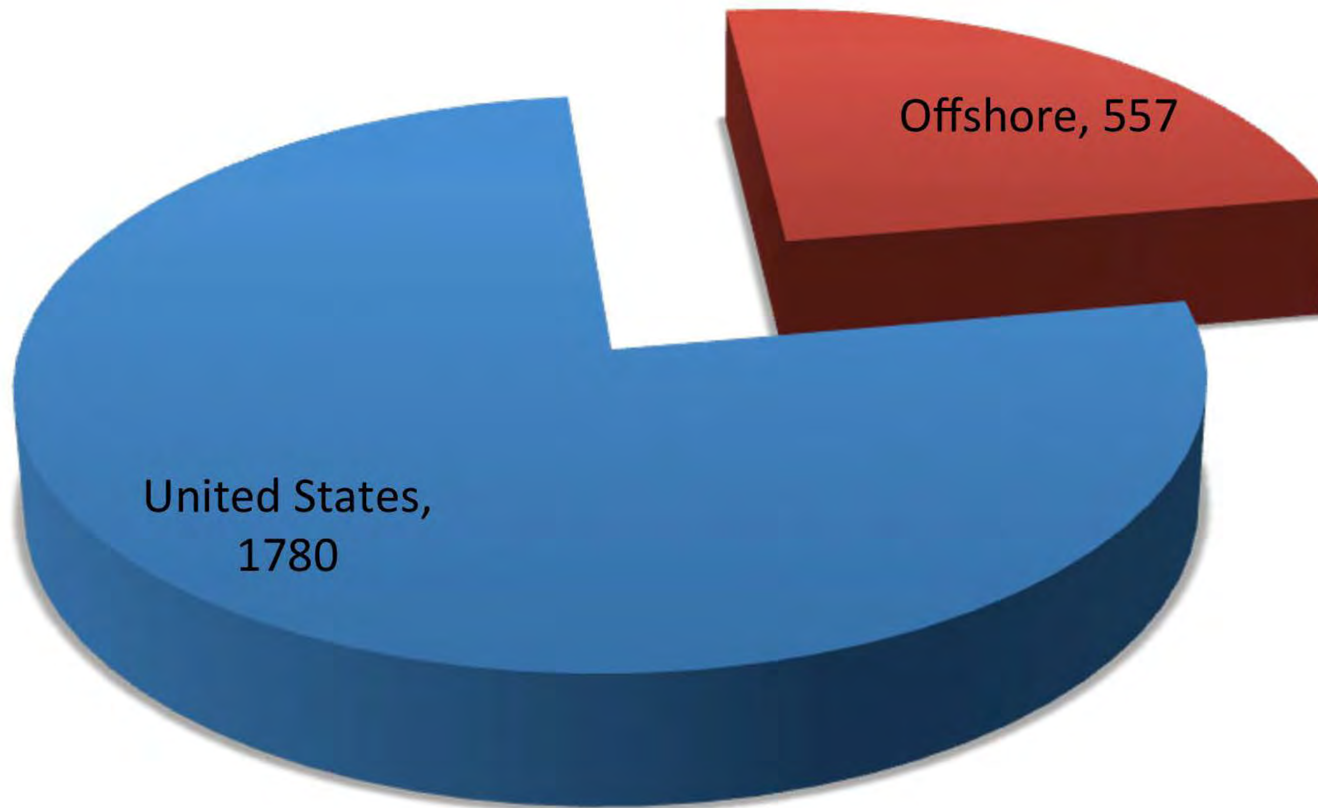
JP Morgan Subsidiaries: Domestic* vs. Offshore



*To avoid a misleading impression, the domestic number excludes 656 subsidiaries (all JPM Plymouth Park Tax Services, LLC entities) because they appear to be shell companies that exist solely to hold delinquent property tax liens used to foreclose on homes in the U.S..

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JP Morgan Subsidiaries by Country

BAHAMAS, 6
CHINA, 17
BRITISH VIRGIN ISLANDS, 6
BRAZIL, 15
GERMANY, 13
JAPAN, 4
MAURITIUS, 13
NIGERIA, 2
AUSTRIA, 1
AUSTRALIA, 22
SOUTH AFRICA, 3
BERMUDA, 1
CAYMAN ISLANDS, 48
ITALY, 1
JERSEY, 13
MEXICO, 11
NETHERLANDS, 20
PAKISTAN, 1
PHILIPPINES, 1
NEW ZEALAND, 1
CANADA, 12
INDONESIA, 3
FRANCE, 3
ARGENTINA, 5
GUERNSEY, 6
CHILE, 6
HONG KONG, 23
KOREA, 3
BARBADOS, 1
IRELAND, 9
COLOMBIA, 10
PUERTO RICO, 5
RUSSIA, 3
SAUDI ARABIA, 2
INDIA, 9
LUXEMBOURG, 21
MALAYSIA, 4
SINGAPORE, 5
SPAIN, 10
SWITZERLAND, 2
TAIWAN, 2
THAILAND, 13
TURKEY, 5
UNITED KINGDOM, 196
UNITED STATES, 1780

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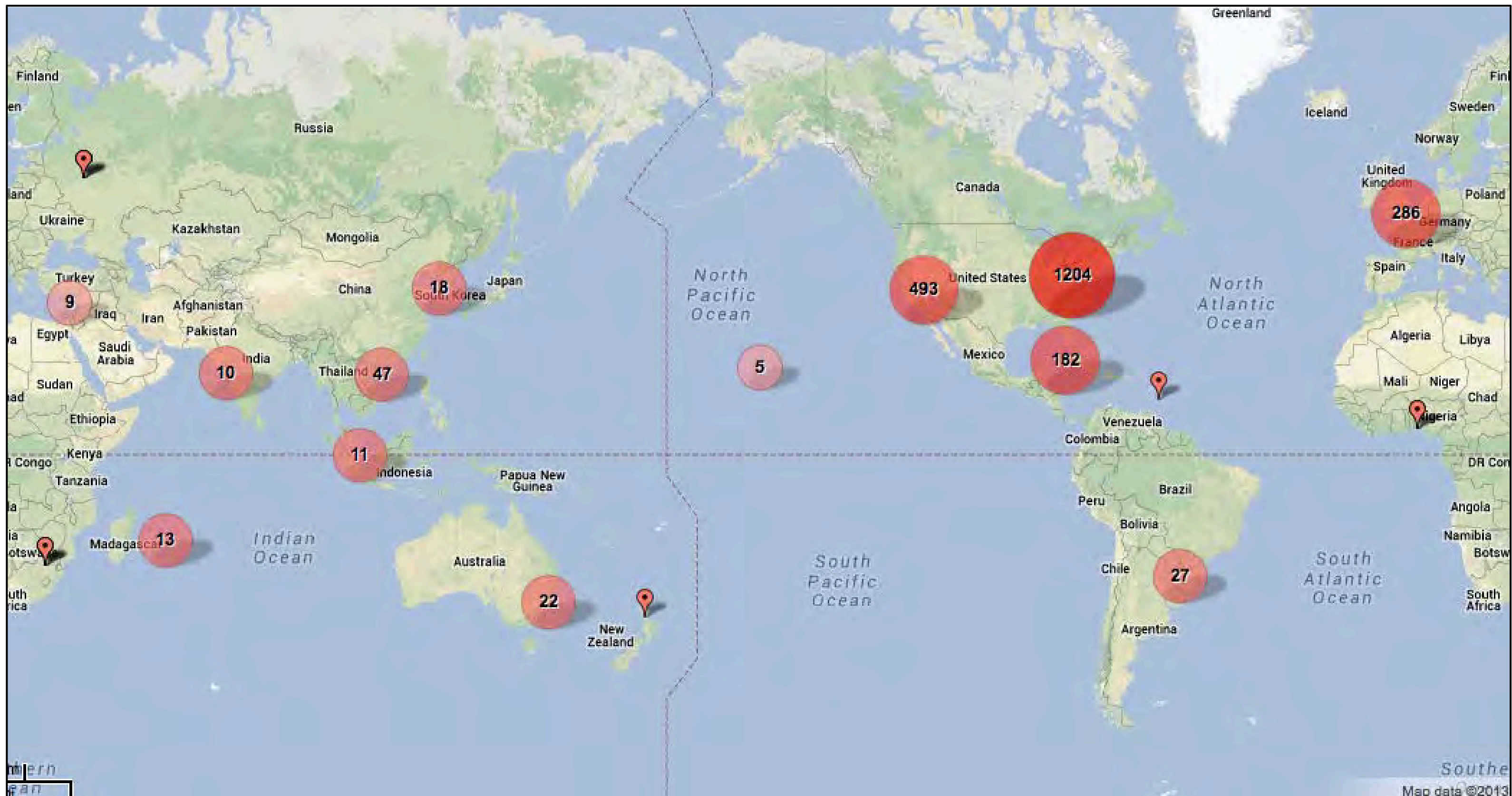
JP Morgan Global Operations



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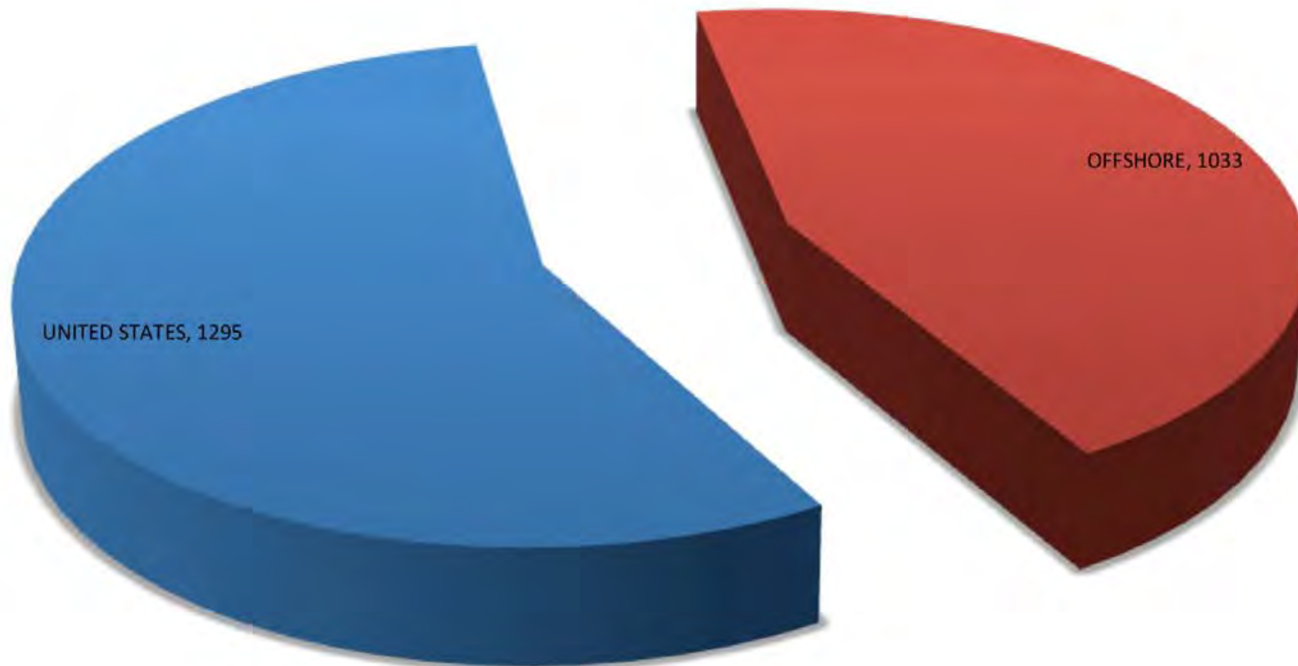

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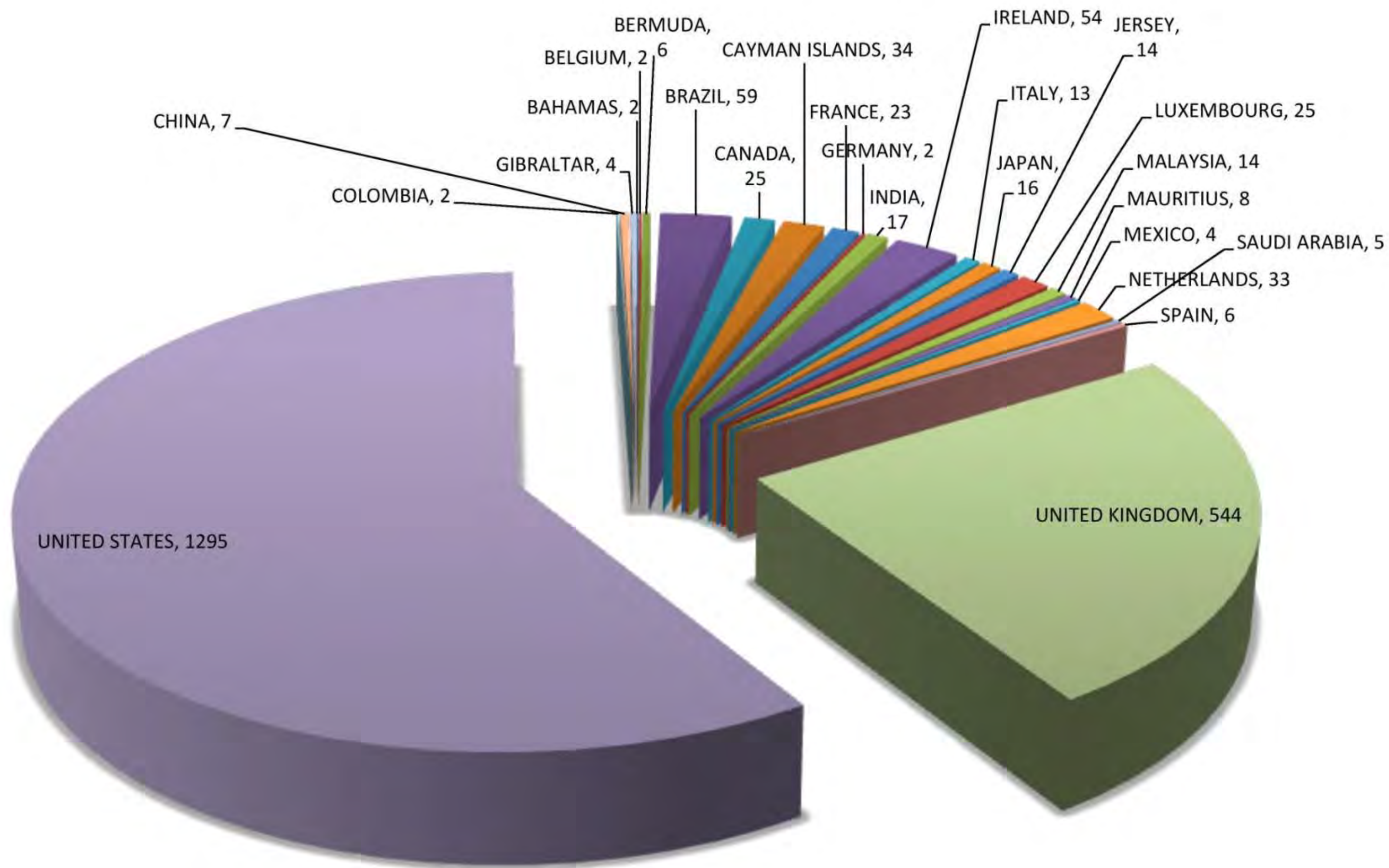
Bank of America Subsidiaries by Country



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Bank of America's European Operations

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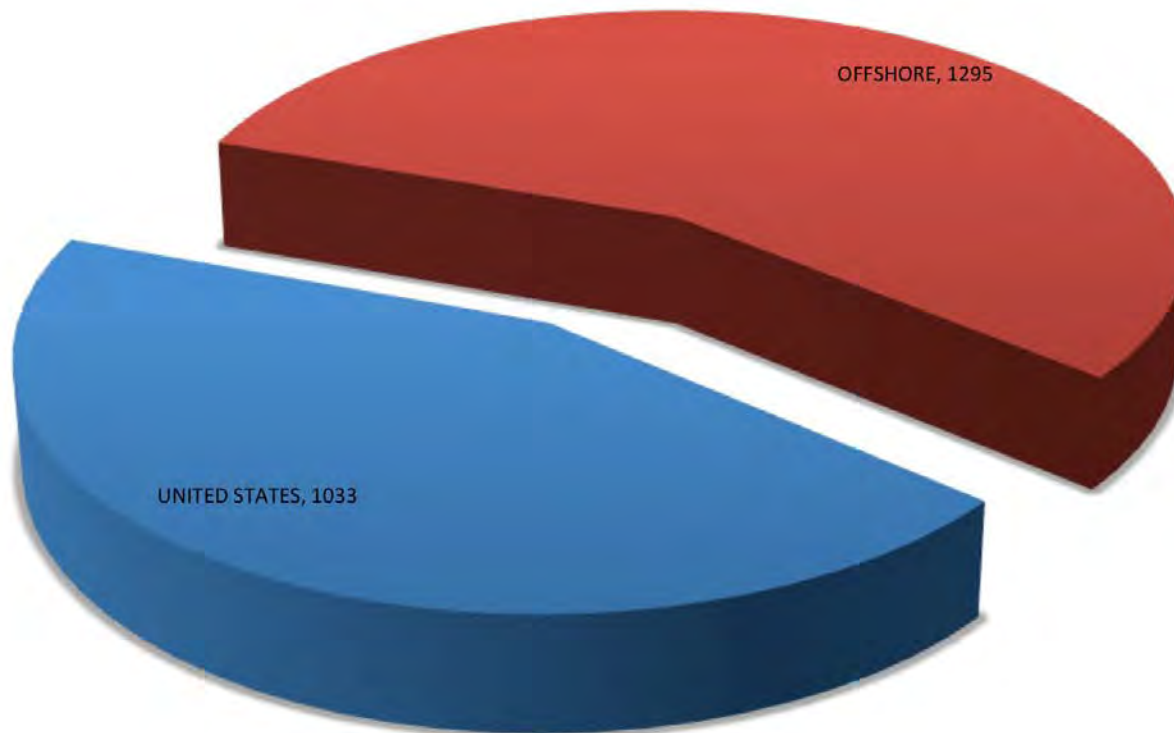
Goldman Sachs Subsidiaries Domestic vs Offshore



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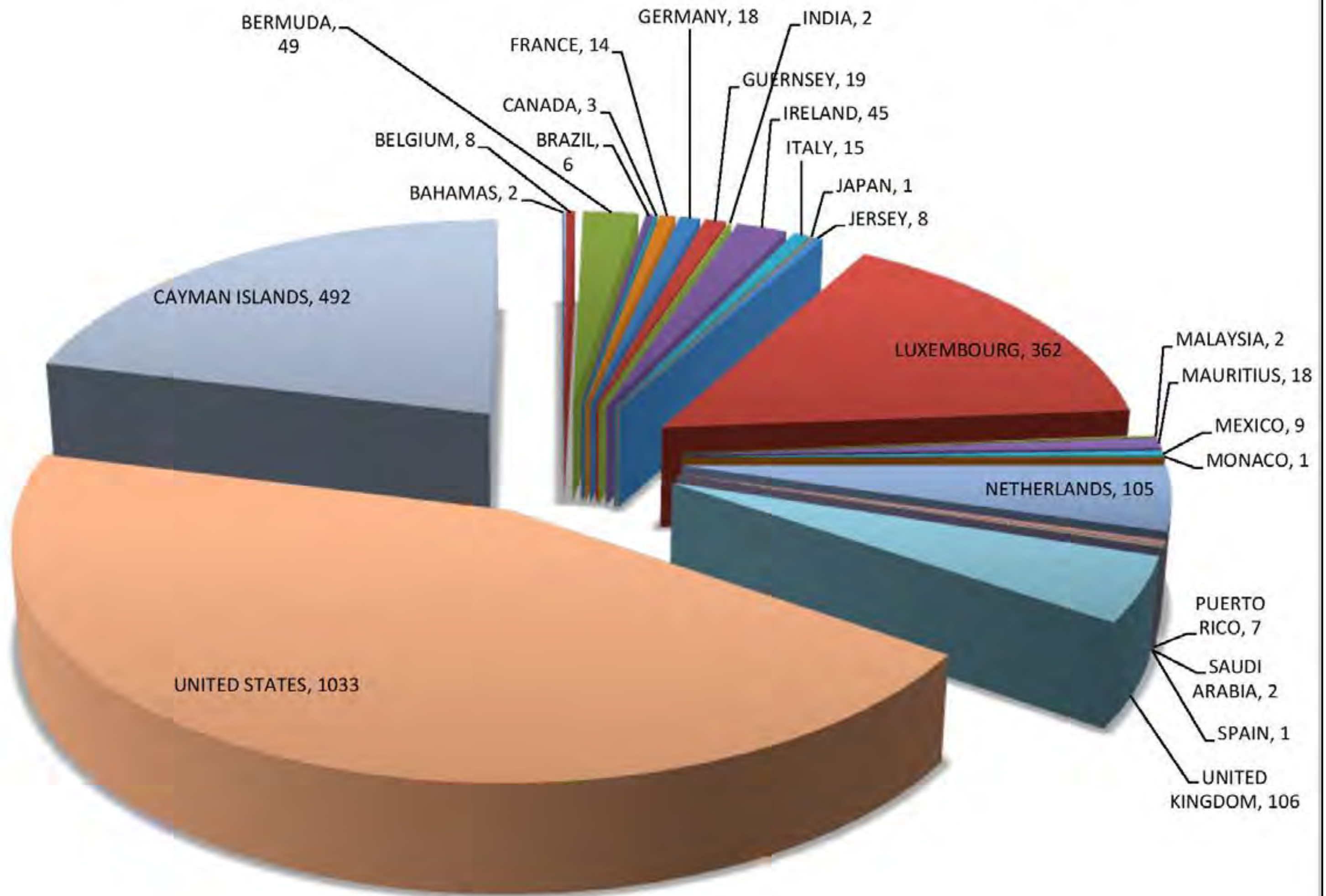
Goldman Sachs Subsidiaries by Country



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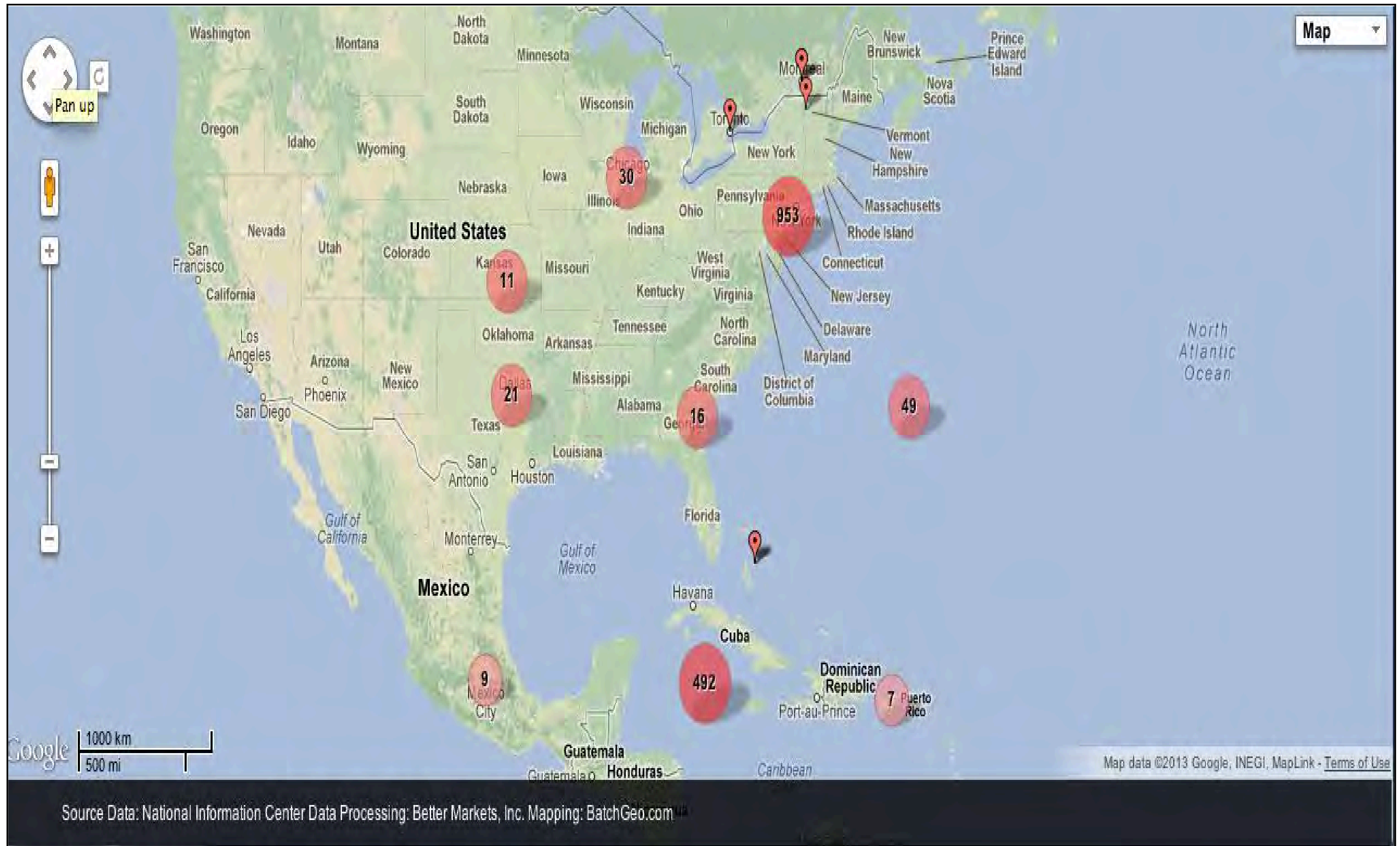
Goldman's North America Operations



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Global banks are experts at moving business activities anywhere in world

AMERICAN BANKER

U.S. Banks Spawn 10,000 Units to Cut Taxes, Avoid Regulation

Bloomberg News
JUL 23, 2012 4:06pm ET

The biggest U.S. banks created more than 10,000 subsidiaries in the past 22 years as they expanded, using legal structures to pay lower taxes and escape tighter regulation, according to a Federal Reserve study.

JPMorgan Chase & Co., the largest U.S. lende ... he m
Group Inc., Morgan Stanley and Bank of America
Federal Reserve Bank of New York shows. Citigroup

Critics including Thomas Hoenig, a Federal Deposit Insura
are too complicated to manage. The 2010 Dodd-Frank Act
largest banks, if they get into trouble, can be wound down
system. U.S. Senator Sherrod Brown has proposed legisla

The biggest U.S. banks created more than 10,000 subsidiaries in the past 22 years as they expanded, using legal structures to pay lower taxes and escape tighter regulation, according to a Federal Reserve study.

"When regulators are left to curtail the risk of trillion- dollar
know that too big to fail is also too big to manage" said Brown, an Ohio Democrat and member of the Senate Banking Committee.

The 1999 repeal of the Depression-era Glass-Steagall Act was the main catalyst for the biggest banks getting bigger, the Fed study concluded. The assets of the largest lenders have since tripled to $15 trillion. Hoenig has called for reinstating Glass-Steagall, which separated investment and commercial banking, while Brown's proposal would limit asset size.

Legal Status

Morgan Stanley and Goldman Sachs, whose main business is investment banking, have thousands more subsidiaries than some of their bigger peers, who focus more on commercial and consumer lending. The two New York-based firms changed their legal status to bank holding companies during the height of the financial crisis in 2008 to access unrestricted Fed funds.

Goldman Sachs and Morgan Stanley each have about 3,000 legal units, more than double the 1,366 entities controlled by Wells Fargo & Co., according to the Fed study. San Francisco- based Wells Fargo has roughly 40 percent more assets than Goldman Sachs and 75 percent more than Morgan Stanley.

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"All the News That's Fit to Print"

The New York Times

Late Edition

Today, partly sunny, milder, high 46. Tonight, turning mostly cloudy, but not as cold, low 35. Tomorrow, cloudy, showers arriving, high 45. Weather map appears on Page D8.

VOL. CLVII . . No. 54,231 © 2008 The New York Times New York, Tuesday, May 21, 2013 $1.25

BILLIONS IN TAXES AVOIDED BY APPLE, U.S. INQUIRY FINDS

Global Web of Subsidiaries Shields Profits – Executives to Testify in Defense

WASHINGTON — Even as Apple became the nation's most profitable technology company, it avoided billions in taxes in the United States and around the world through a web of subsidiaries so complex it spanned continents and went beyond anything most experts had ever seen, Congressional investigators disclosed on Monday.

The investigation is expected to set up a potentially explosive confrontation between a bipartisan group of lawmakers and Timothy D. Cook, Apple's chief executive, at a public hearing on Tuesday.

Congressional investigators found that some of Apple's subsidiaries had no employees and were largely run by top officials from the company's headquarters in Cupertino, Calif. But by officially locating them in places like Ireland, Apple was able to, in effect, make them stateless — exempt from taxes, record-keeping laws and the need for the subsidiaries to even file tax returns anywhere in the world.

"Apple wasn't satisfied with shifting its profits to a low-tax offshore tax haven," said Senator Carl Levin, a Michigan Democrat who is chairman of the Senate Permanent Subcommittee on Investigations that is holding the public hearing Tuesday into Apple's use of tax havens. "Apple successfully sought the holy grail of tax avoidance. It has created offshore entities holding tens of billions of dollars while claiming to be tax resident nowhere."

Thanks to what lawmakers called "gimmicks" and "schemes," Apple was able to largely sidestep taxes on tens of billions of dollars it earned outside the United States in recent years. Last year, international operations accounted for 61 percent of Apple's total revenue.

Investigators have not accused Apple of breaking any laws and the company is hardly the only American multinational to face scrutiny for using complex corporate structures and tax havens to sidestep taxes. In recent months, revelations from European authorities about the tax avoidance strategies used by Google, Starbucks and Amazon have all stirred public anger and spurred several European governments, as well as the Organization for Economic Cooperation and Development, a Paris-based research organization for the world's richest countries, to discuss measures to close the loopholes.

Still, the findings about Apple were remarkable both for the enormous amount of money involved and the audaciousness of the company's assertion that its subsidiaries are beyond the reach of any taxing authority.

"There is a technical term economists like to use for behavior like this," said Edward Kleinbard, a law professor at the University of Southern California in Los Angeles and a former director at the Congressional Joint Committee on Taxation. "Unbelievable chutzpah."

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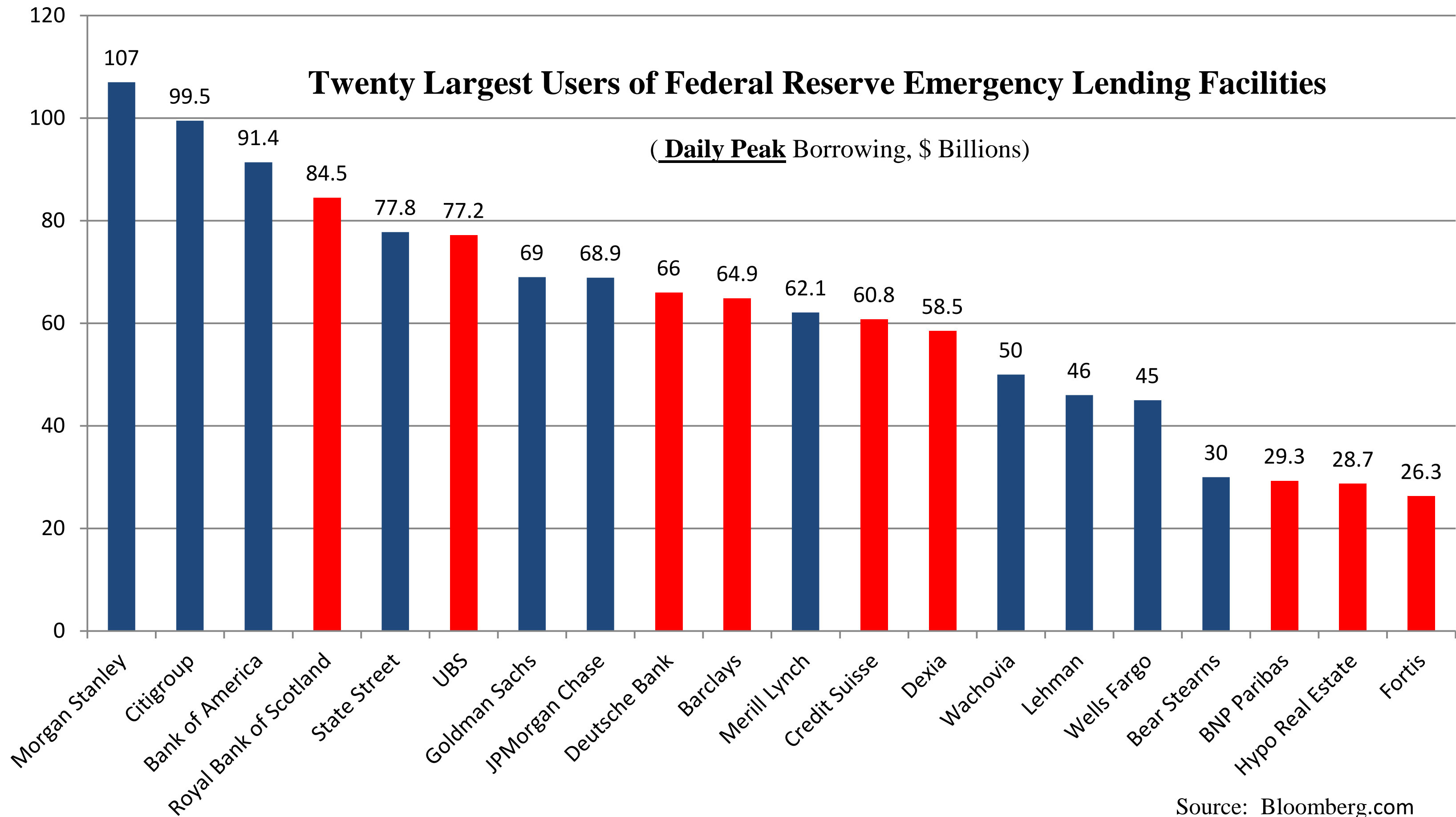
EU banks required U.S. bailouts

(blue U.S., red European)



Source: Bloomberg.com

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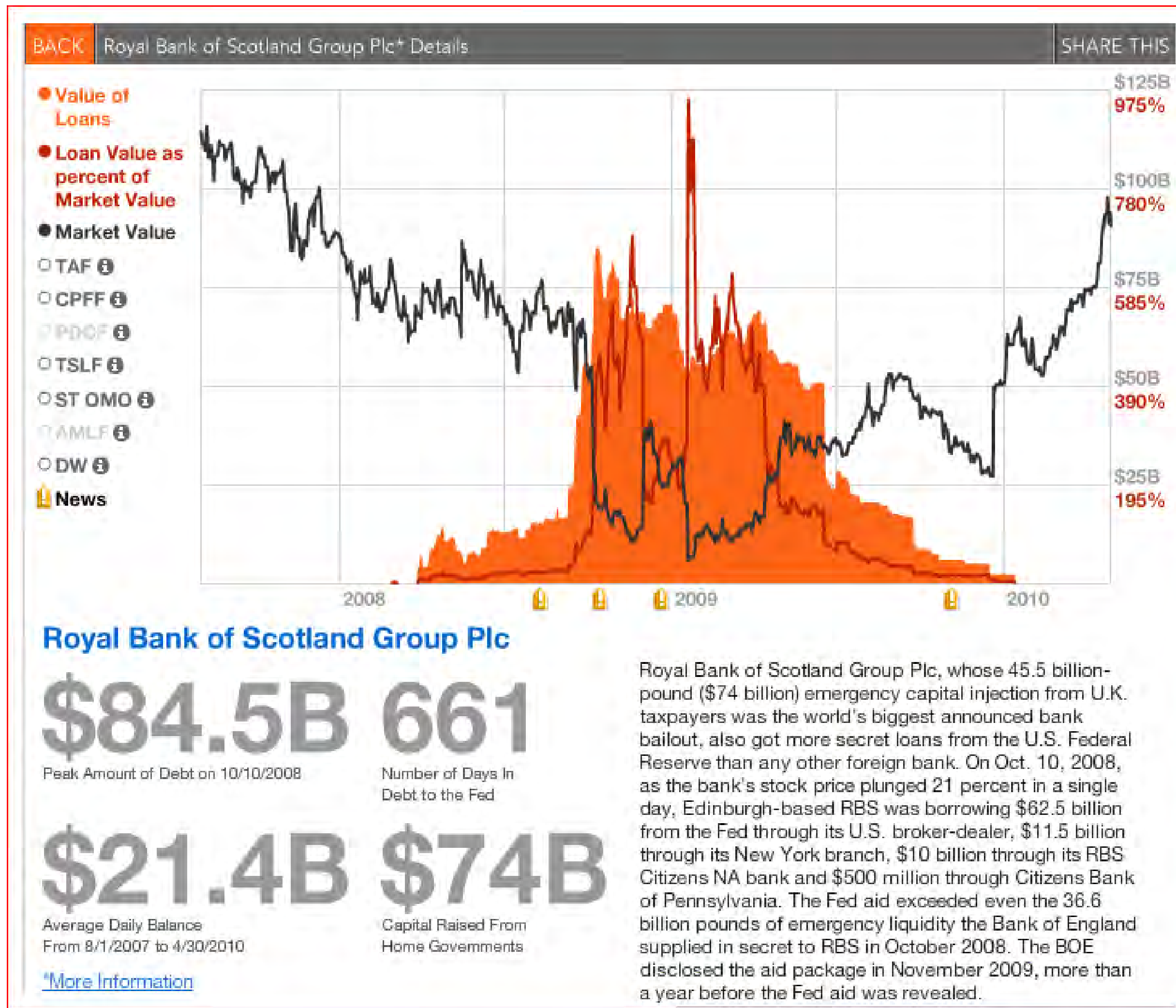
Fed lending to Royal Bank of Scotland (RBS)



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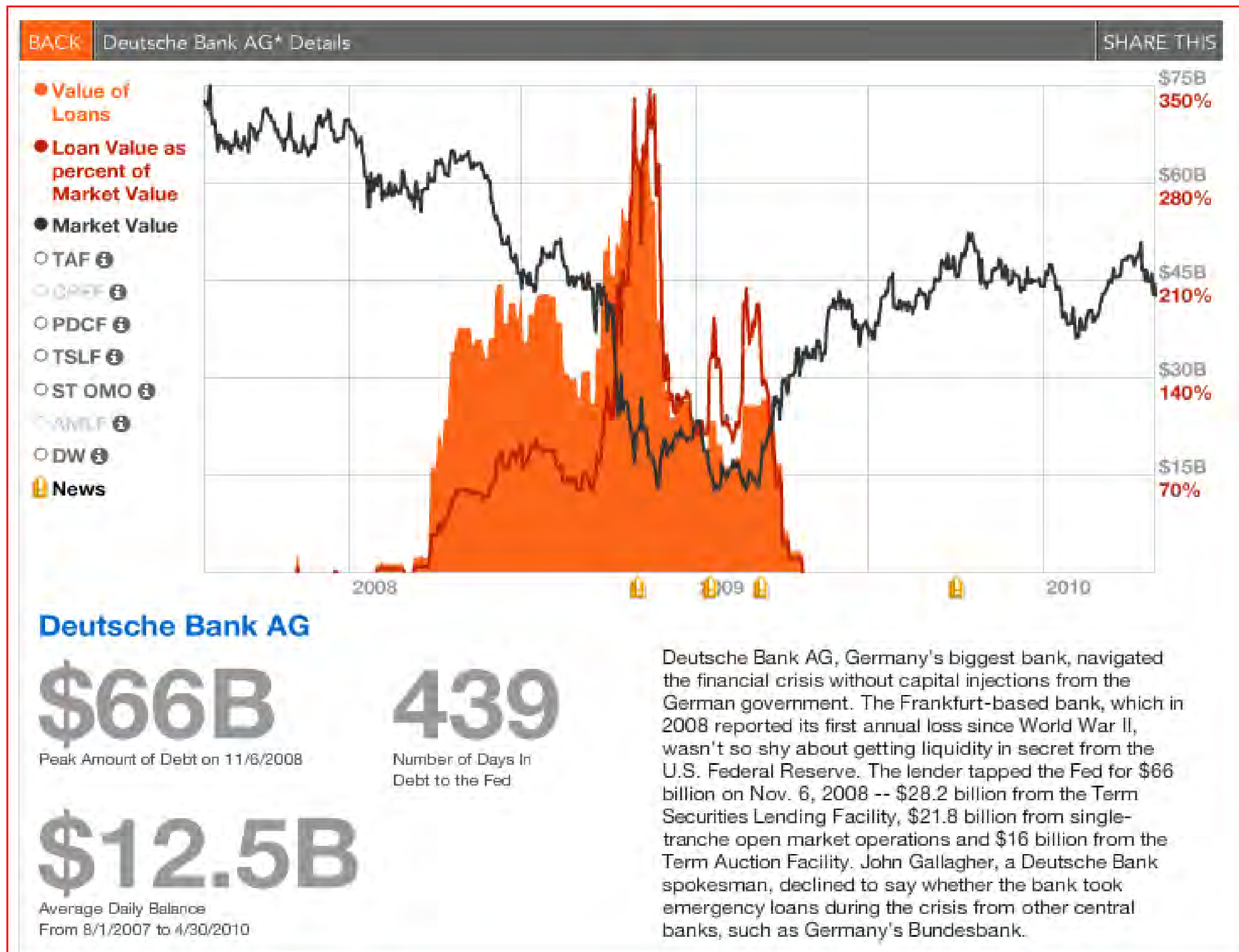
Fed lending to Deutsche Bank



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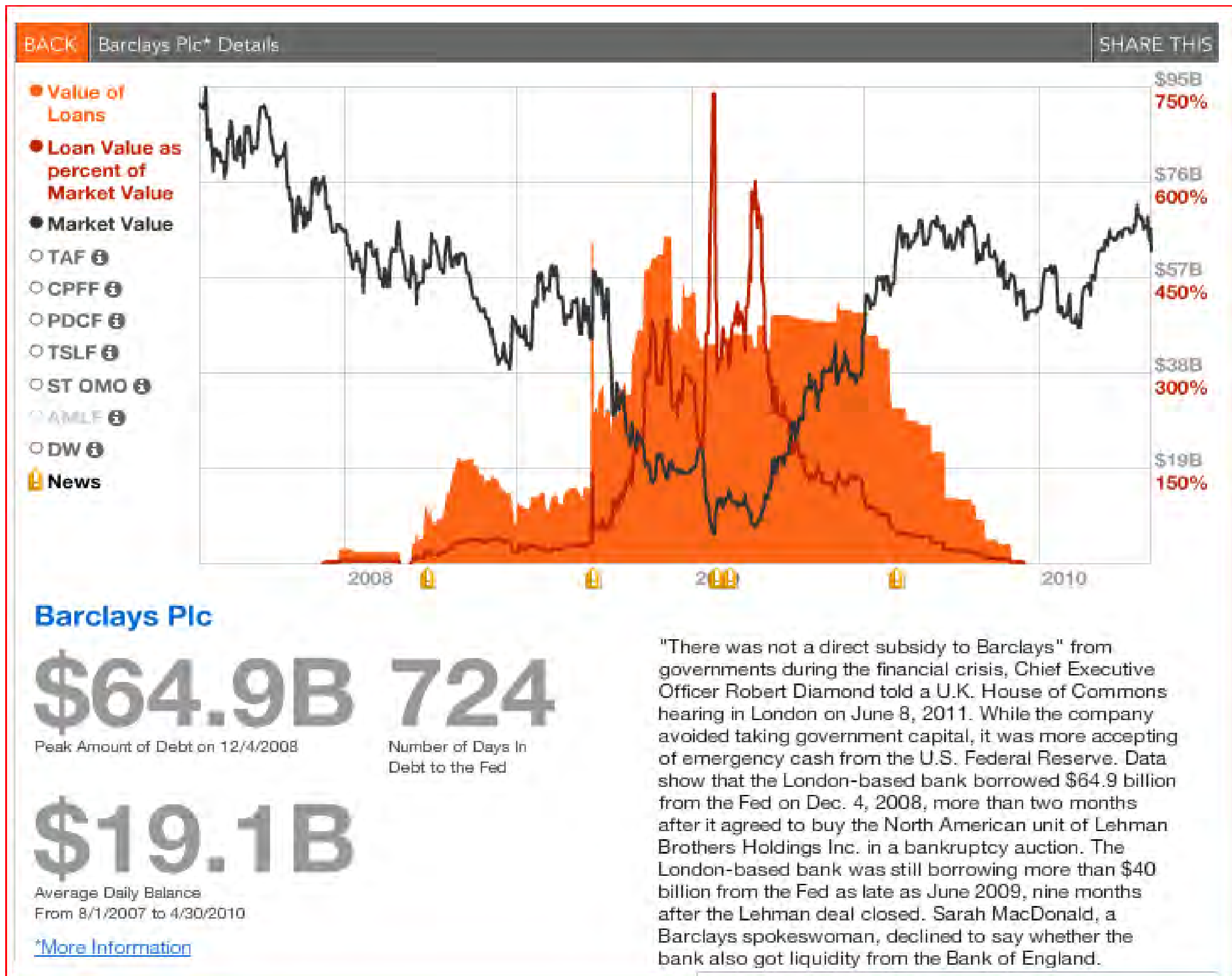
Fed lending to Barclays



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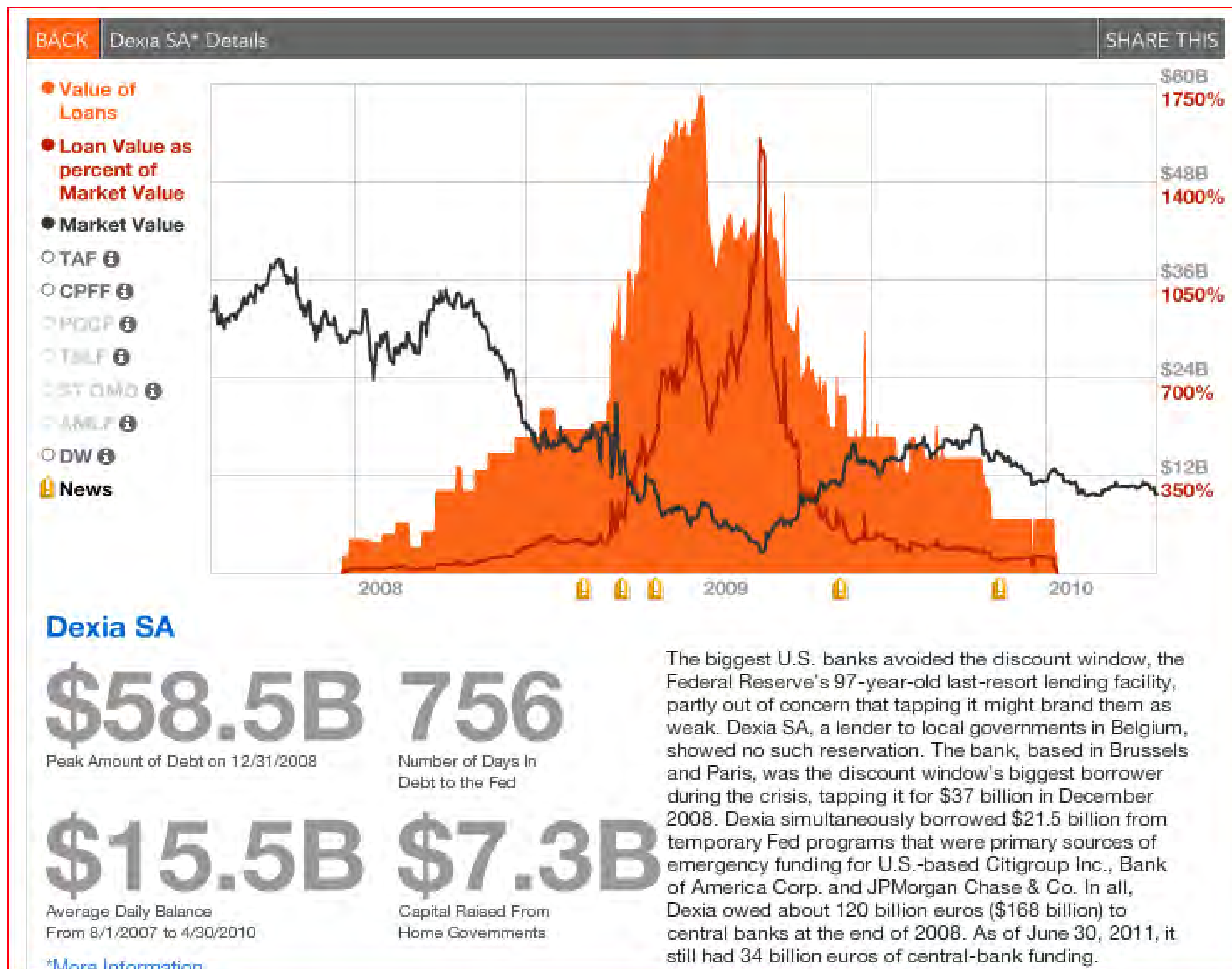
Fed lending to Dexia SA



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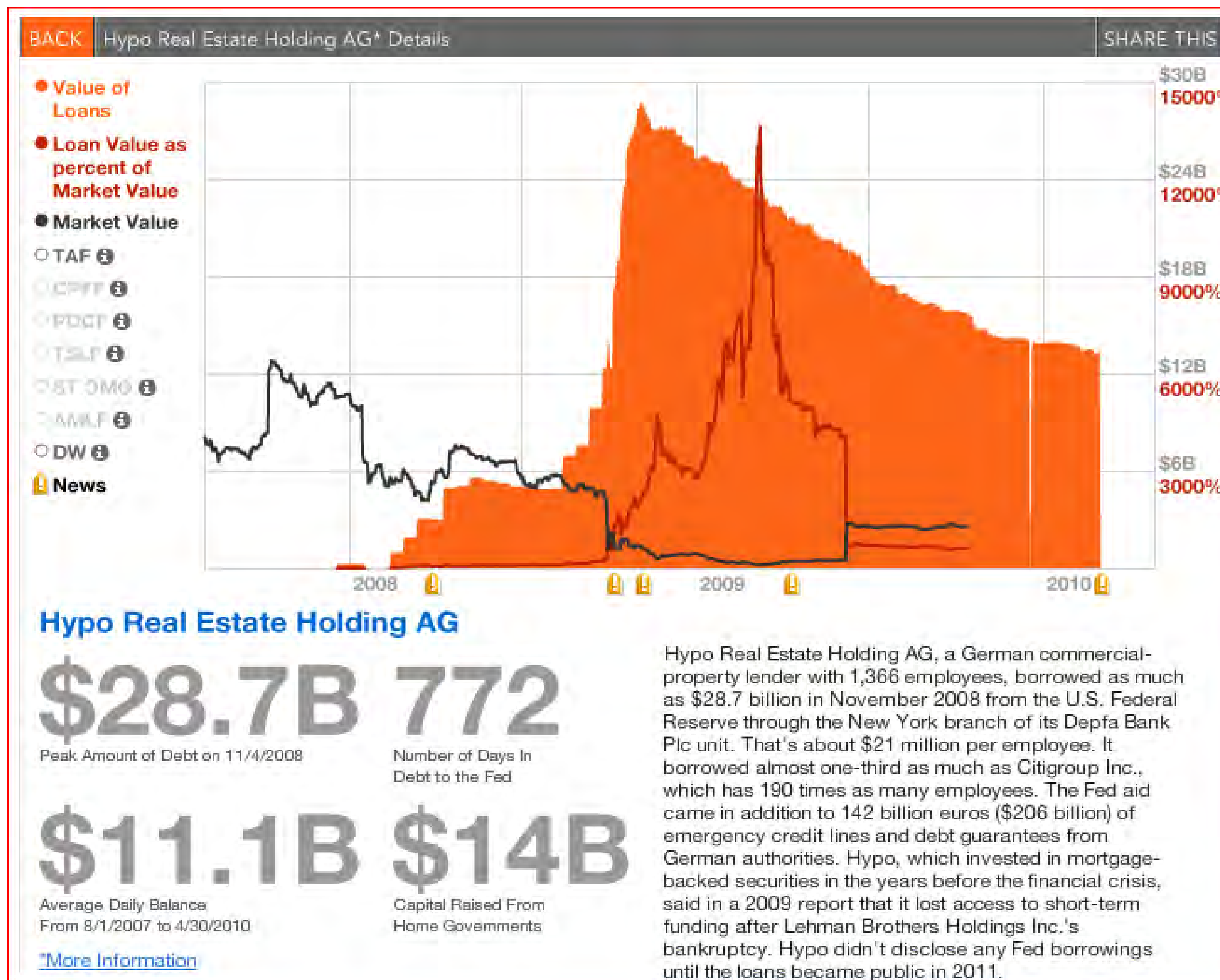
Fed lending to Hypo Real Estate Holding



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But even that's not all: Costs of Foreign Regulator Failures have been staggering

- **In addition** to (1) the AIG-like cross border bank/dealer disasters that have come back to cost the U.S. **and** (2) the trillions in Fed bailouts,
  - There was **also** massive, widespread and very costly failure of foreign financial regulation even of their own banks and dealers – **never mentioned**
- The result was many EU banks were nationalized or otherwise bailed out by their own governments during the crisis

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EU bank regulation totally failed
Foreign depositors, taxpayers and treasuries

EU Banks rescued by their governments during the crisis

U.K.	Germany
Northern Rock *	West LB
Royal Bank of Scotland *	Landesbank Baden Wurttemberg
Lloyds Banking Group	IKB
Bradford and Bingley *	Hypo Real Estate *
HBOS	Nord LB
	Commerzbank AG
Belgium	
	Netherlands
Dexia *	
KBC Group	ING
Fortis	SNS REAAL
France	Sweden
Caisse d'Espargne/Bansque Populaire	Carnegie Bank *
Ireland	Switzerland
Anglo Irish Bank *	UBS

Source: Centre for European Policy Studies (2010), Bank State Aid in the Financial Crisis, October

*government majority ownership

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£0.80
Monday 13.10.08
Published in London and Manchester
guardian.co.uk

the guardian

Banks to get £46bn injection from taxpayers to stay afloat

Fears that bill may rise to £75bn

Jill Treanor
Larry Elliott
Nicholas Watt

The cost to the taxpayer of bailing out Britain's weakest banks will escalate today when the government announces an injection of more than £40bn into the country's struggling high street lenders.

In a sign of the deepening financial crisis, the government is standing by to take majority stakes in Royal Bank of Scotland and HBOS, owner of the country's biggest mortgage lender Halifax, and smaller stakes in Barclays and Lloyds TSB.

Top executives from the big banks were in discussions with the Financial Services Authority, Treasury and Bank of England last night about how they would participate in the bail-out, originally intended to allow for £25bn to be injected into banks immediately, with a further £25bn later.

But RBS and HBOS are likely to use £25bn alone, and there were estimates last night that the total bill could rise to £75bn. The three-part package also includes £200bn of fresh funds for interbank lending and a

Sir Fred Goodwin could be ousted as chief executive of RBS, in which the government is ready to take a majority stake

tion of making a statement before markets open at 8am. Sources said yesterday that the government would assume a larger than expected control of banks after the dramatic fall in their share prices. They cite the example of RBS, which is now worth £12bn but needs at least £20bn to help it recapitalise. "On these figures we are suddenly the majority shareholder," one government source said.

HBOS, which had a market value of £6.5bn on Friday, could need to raise up to £12bn and Lloyds TSB £5bn, with Barclays needing up to £9bn. The terms of the fund-raisings are complex. Some of the shares may be ordinary shares, which give voting rights, and some could be preference shares, which do not. HBOS, for instance, could raise around £9bn in ordinary shares and a further £3bn in preference shares, while RBS could raise £15bn in ordinary shares and £5bn in preference shares.

The rise in the size of the capital injections being demanded by the FSA over the weekend surprised some banks. But it is thought that the regulator is determined to draw a line under concerns about whether the capital cushions held by the banks are enough to prevent them collapsing.

The government insisted it was not taking control of banks in the long term. "This is not nationalisation. This is the banks coming to us requesting capital," the government source said. "If we are going to take a significant share of these banks, we have got to protect the interests of the taxpayer. But we have no intention

Europe follows Brown plan for survival

Ian Traynor Paris
Larry Elliott Washington

Germany, France, Italy and a further 12 European countries last night unveiled a "comprehensive" plan for salvaging their banking systems from potential ruin, as panicked European leaders met to try to ward off more financial meltdown before the markets reopen today.

An emergency summit in Paris of the 15 countries using the euro single currency was encouraged by Gordon Brown to adopt the rescue plan he launched last week as the template for an increasingly global approach to the financial crisis.

Yesterday's summit in Paris followed a frenetic weekend of activity in Washington, in which the IMF, the World Bank, the G7 club of rich western nations and the broader G20 group, all called for urgent and coordinated action.

Dominique Strauss-Kahn, managing director of the IMF, warned that the global financial system was "on the brink of systemic meltdown".

The IMF's main policy committee issued a statement saying that it "recognises that the depth and systemic nature

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FINANCIAL TIMES

Tuesday January 20 2009 | £1.80

Good morning, Mr President

Inauguration day: the world wakes up to Obama's Washington

Analysis Page 11, **Editorial Comment** Page 12, Plus **Special report**

Crunch time
Nationalise the banks now, says Christopher Wood
Page 36

Newspaper of the year | World Business Newspaper

News Briefing

C4 chief seeks a 'best for Britain' solution

Diageo reviews plans

Art market crunch

S&P cuts Spain's rating

Russian lawyer killed

Gaza rebuilding row

Indian retail revolution

Rouble devaluation off

Turkey pipeline threat

RBS plunges despite lifeline

Fears of state takeover after 67% share fall

Treasury unwilling to take on balance sheet

Prime minister Gordon Brown and chancellor Alistair Darling announce the second rescue plan for the banking industry

RBS suffers on the markets

£28bn
RBS set for biggest loss in UK corporate history

67%
Slide in the bank's shares to a 22-year low of 11.6p

PM's rebuke

'Today's write-off is for irresponsible losses in US subprime markets that partly derive from the acquisition of ABN'

Stephen Hester

'RBS leveraged itself too much in the good times – the ABN acquisition was an element in that...'

RBS chief executive

Bank of England

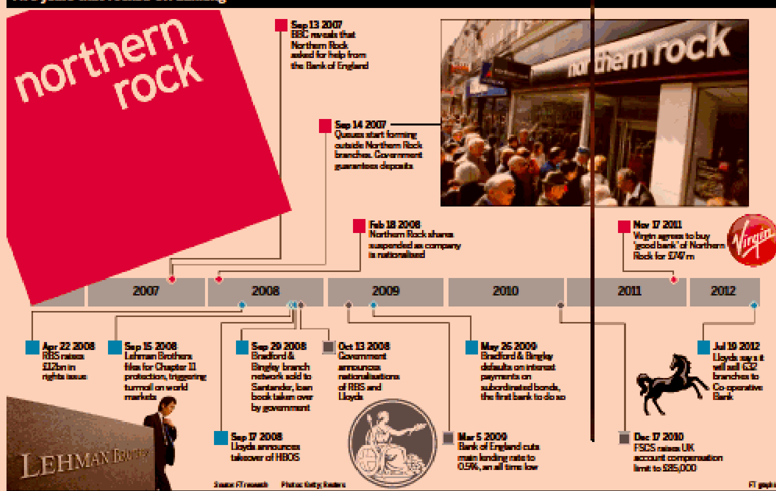
Treasury gives go-ahead to 'print money'

Rock's fall has left millions in a hard place

Banking

Jonathan Eley, Elaine Moore and Tanya Powley look at how Northern Rock's dramatic failure affected investors, savers and mortgage borrowers

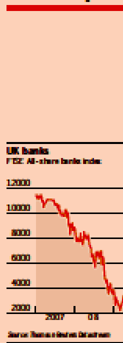
Five years that rocked UK banking



MORE ON THE WEB

UK banks

FTSE All-share banks index



238

100 per cent mortgage deals available in Sept 2007

5

100 per cent mortgage deals available in Sept 2012

Savings

Mortgages

Investors

Former Northern Rock chief executive Adam Applegarth

The Bank of England is considering another rate cut

Bravo! Top talent worth applauding.

Henderson Sterling Bond Unit Trust

AAA

HGi.co/gh2

Expect something special

Henderson GLOBAL INVESTORS

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Foreign financial regulators failed miserably to protect their own taxpayers, depositors, treasuries

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The costs of those failures have been staggering, exceeding GDP

- Because these costs are ongoing, it's impossible to calculate how much these failures will ultimately cost the people of Europe
  - But we know the peak government bailout costs in just one country: the nationalized cost in the UK alone to 2011 was more than $1.15 trillion pounds

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Trillions More in Costs to European Citizens

- Because these banks/dealers were nationalized, their total liabilities have been assumed by the public
  - **Just one** of the five UK nationalized dealer banks' RBS, had total assets (& therefore total liabilities) in 2008 of 2.2 trillion pounds
    - The UK's entire GDP in 2008 was just 1.4 trillion pounds
      - The country's taxpayers have had to assume private liabilities well above their entire GDP

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Foreign financial regulation has failed shamefully in other areas as well

- There has also been massive, wide-spread, multi-year LIBOR rate-rigging throughout the EU by the large dealer derivatives desks
- Plus, there has been massive, wide-spread, multi-year criminal money laundering by Standard Chartered, HSBC and other global bank/dealers, which was also undetected by European regulators
- And, ongoing: ISDAfix markets, FX markets & who knows what other crimes & manipulation going on

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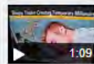
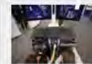
Traders Said to Rig Currency Rates To Profit Off Clients


Sleepy Trader Creates Temporary Millionaire


Brain Can't Text While Driving Even Without Hands: AAA

Traders Said to Rig Currency Rates to Profit Off Clients

By Liam Vaughan, Gavin Finch & Ambereen Choudhury - Jun 11, 2013 7:00 PM ET

June 11, 2013

58 COMMENTS QUEUE

Traders at some of the world's biggest banks manipulated benchmark foreign-exchange rates used to set the value of trillions of dollars of investments, according to five dealers with knowledge of the practice.

> Traders at some of the world's biggest banks manipulated benchmark foreign-exchange rates used to set the value of trillions of dollars of investments, according to five dealers with knowledge of the practice.

Employees have been front-runn[...] through trades before and during the [...] the current and former traders, who req[...] Dealers colluded with counterparts to b[...] people, who worked in the industry for a[...]

The be[...] market[...] the value of funds and derivatives, the two traders said. The Financial Conduct Authority, Britain's markets supervisor, is considering opening a probe into potential manipulation of the rates, according to a person briefed on the matter.

Enlarge image

A boy adjusts number tiles displaying the exchange rate on a currency exchange board at night in Bishkek, Kyrgyzstan. Photographer: Noriko Hayashi/Bloomberg

June 12 (Bloomberg) – Bloomberg News' Liam Vaughn explains the process of currency trading and how traders are said to have rigged FX rates as Britain's market supervisor considers opening a probe into the practice. He speaks on Bloomberg Television's "On The Move."

"The FX market is like the Wild West," said James McGeehan, who spent 12 years at banks before co-founding Framingham, Massachusetts-based FX Transparency LLC, which advises companies on foreign-exchange trading, in 2009. "It's buyer beware."

The $4.7-trillion-a-day currency market, the biggest in the financial system, is one of the least regulated. The inherent conflict banks face between executing client orders and profiting from their own trades is exacerbated because most currency trading takes place away from exchanges.

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Why would the U.S. CFTC outsource the protection of U.S. taxpayers to anyone with such a poor record?

- In addition, foreign governments have a conflict of interest in enforcing effective rules on foreign banks: less or ineffective regulation will attract business & jobs to their country, with limited downside b/c U.S. pays the bill to bailout the global financial system
- That is why the CFTC was explicitly given the statutory mandate & duty to regulate these markets & market participants directly
  - To protect the U.S. financial system, U.S. economy & U.S. taxpayers
  - **If** substituted compliance is allowed, it must be robust in form, substance, enforcement & over time

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No More Delays: already 2 ½ years of CFTC consideration

- First CFTC meeting on cross border Jan. 2011
  - A year & a half of meetings, consideration, deliberation AND endless industry input
- Initial guidance proposed June 2012
  - Followed by yet more meetings, input, consideration, deliberation
- Additional guidance Dec. 2012, setting deadline of July 12, 2013, 7 months later
- After yet MORE input, latest draft circulated on May 16, 2 months before the deadline of July 12

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The American People have been waiting years already

- 3 years since the Dodd Frank financial reform law was passed
  - July 12, 2013 cross border deadline
  - July 21, 2010 Obama signed DFA
- 5+ years since the financial crisis
  - March 17, 2008 Bear Stearns failed
  - September 5, 2008 Fannie/Freddie receivership
  - September 15, 2008 Lehman Brothers failed
    - 2013 – this year – 5 year anniversary

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CFTC Must Finalize By July 12

- After more than 2 ½ years, it is time to finalize
- 4+ weeks left to work out any differences
  - Plenty of time
- SEC's recently proposed rule is inapplicable & weak
  - No basis for delay
- Objections based on speculation by foreign governments/industry no basis for delay
  - Will take years for them to put rules in place
  - Conflicts, **if any**, can be worked out later
- The time to protect the American people is NOW
  - Do not wait & do not start with lower standards
    - Can always change to address concerns; simply won't be able to increase

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Coming to a **U.S.** City Near You? **Not if** the CFTC Gets Cross Border Right

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Don’t Let This Happen <u>Again</u>

THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION

A Report From

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