



September 29, 2017

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Request for Information on Project KISS (Keep It Simple Stupid), RIN 3038-AE55

Dear Mr. Kirkpatrick,

Better Markets Inc.¹ appreciates the opportunity to comment on the above-captioned Request for Information (“RFI”),² issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”).

BACKGROUND

On March 15th of this year, CFTC Chairman Giancarlo announced the launch of “Project KISS,” describing it as “an agency-wide review of CFTC rules, regulations, and practices to make them simpler, less burdensome and less costly.”³ The Chairman explained that the KISS initiative was an outgrowth of Executive Order (“E.O.”) 13777, signed by President Trump on February 24, 2017.⁴ That order required executive branch agencies to designate a “Regulatory Reform Officer” and to establish a “Regulatory Reform Task Force” with a mandate to “evaluate existing regulations . . . and make recommendations to the

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans’ jobs, savings, retirements, and more.

² 82 Fed. Reg. 23765 (May 24, 2017).

³ Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, Mar. 15, 2017, at 2 (“Remarks”).

⁴ Executive Order 13777, Enforcing the Regulatory Reform Agenda, 82 Fed. Reg. 12285 (Mar. 1, 2017).

agency head regarding their repeal, replacement, or modification.”⁵ Chairman Giancarlo acknowledged that as an independent regulatory agency, the CFTC was “not strictly bound” by E.O. 13777, but he nevertheless announced that the KISS rule review would be conducted “pursuant to the president’s order.”⁶

On May 3rd, the Commission issued a press release, followed by the RFI, announcing that as part of Project KISS, it was soliciting input “regarding how the Commission’s existing rules, regulations, or practices could be applied in a simpler, less burdensome, and less costly manner.”⁷ The press release and the RFI both cautioned that during this phase of the KISS initiative, the Commission was not seeking input “about identifying existing rules for repeal or even rewrite.” The Commission also posted on its website a list of five overarching categories of regulation, including swaps, on which it was seeking input: registration, reporting, clearing, executing, and miscellaneous.⁸

SUMMARY

Project KISS raises a serious concern that its inevitable consequence will be to weaken the regulatory structure that the Commission carefully crafted and previously adopted to ensure that our commodities and derivatives markets are as stable, transparent, and fair as possible. The Chairman’s Remarks and the RFI include language framing the goals of the KISS initiative in unmistakably de-regulatory terms. For example, repeatedly included among its principal objectives is to “reduce regulatory burdens and costs for participants in the markets we oversee.”⁹ These are often used as benign-sounding code words for attempts at weakening rules to reduce the costs and burdens on industry, without sufficient regard for the essential role that the rules play in protecting the public interest.

The Chairman appears to have embraced the Administration’s de-regulatory agenda. Project KISS is one clear example of the Chairman’s willingness to follow de-regulatory executive orders even when they are inapplicable to the CFTC. Another striking example is Executive Order 13771. Signed by President Trump on January 30, 2017, it requires all executive branch agencies to eliminate two rules for every single new rule adopted, and to ensure that the costs of any new rule are entirely offset by the repeal of existing rules, without any regard to the benefits of the new or previously adopted rules.¹⁰ Here again the Chairman announced that the Commission would “embrace” that directive—even though it appears to be unconstitutional and unlawful;¹¹ even though it is certain to inflict widespread

⁵ 82 Fed. Reg. at 12286.

⁶ Remarks at 2.

⁷ RFI at 23765.

⁸ Commodity Futures Trading Comm’n, KISS Initiatives, <https://comments.cftc.gov/KISS/KissInitiative.aspx>.

⁹ Remarks at 2.

¹⁰ Reducing Regulation and Controlling Regulatory Costs, Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Feb. 3, 2017).

¹¹ See Am. Compl. for Declaratory and Injunctive Relief, *Public Citizen v. Trump*, 1:17-cv-00253-RDM (D.D.C. Apr. 21, 2017).

harm by forestalling and eliminating rules that protect Americans' health and welfare; and even though it is not binding on any independent agency such as the Commission.

Some of the comments already submitted by industry representatives in response to the RFI confirm the fear that what has been cast as merely a regulatory streamlining exercise may actually result in major revisions that weaken the rules. Despite the repeated assurances that the RFI only seeks streamlining changes in the way the Commission applies its rules, some industry commenters have seized the opportunity to push for much more substantial changes. For example, the International Energy Credit Association's letter¹² proposes a major change in the definition of "Financial Entity" to exclude centralized hedging entities.¹³ Such changes are highly substantive, have huge implications for the swaps regulatory framework, and do not "take the regulations as they are."¹⁴

As explained in our comments below, we oppose Project KISS to the extent it results in any weakening of any of the Commission's rules. Moreover, as the Commission considers possible changes to its rules, or changes in the manner of their application, we urge the Commission to be guided by the language and intent of the Commodity Exchange Act, as amended by the Dodd-Frank Act, and above all, by the public interest. And we urge the Commission to follow a transparent process that provides for notice and a meaningful opportunity for comment on any proposed changes, regardless of their form or content.

COMMENTS

I. Project KISS rests on the mythology of overregulation.

Project KISS is based on the erroneous premise that the derivatives markets and our economy as a whole are struggling under the weight of oppressive financial regulation. This is a myth being fueled by the financial services industry and its allies in government to justify de-regulation that will enrich the industry but restore heightened levels of fraud, abuse, and instability in our financial markets, leading ultimately and inevitably to another financial crisis. In reality, the lending, securities, and derivatives markets are all thriving, while the Dodd-Frank Act reforms are in place and protecting our markets from another disastrous crisis.

Consider some basic data regarding the futures, options, and swaps markets. The Futures Industry Association's annual survey of futures and options trading volume revealed the following:

The total number of futures and options traded on exchanges worldwide reached 25.22 billion contracts in 2016. Although that was only 1.7% higher than the previous year, the increase in the number of contracts traded was

¹² Comment Letter of International Energy Credit Association on Request for Information on Project KISS (Keep It Simple Stupid) at 1 (Aug. 11, 2017).
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61269&SearchText=>

¹³ See 17 C.F.R. 1.3(hhh)(ii)(A).

¹⁴ Remarks at 2.

enough to **set a new annual record for the derivatives exchange industry**. The previous high was set in 2011, when total volume reached 24.98 billion.¹⁵

The idea that the swaps market has been hampered by onerous regulations is also belied by the evidence. During the second quarter of 2017, the dollar volume of Interest Rate Derivatives rose by 14.2% to \$50.8 trillion over the previous year, while the number of trades grew by 7.5% over the same period.¹⁶ This is part of an overall upward trend in both the amount and number of Interest Rate Derivatives over the past three years.¹⁷ Contracts in U.S. dollars remained the most actively traded instruments, and accounted for 66.7% of traded notional value and 53.2% of the number of trades.¹⁸ Indeed there is evidence that the Dodd-Frank Act made the swaps market more vibrant by decreasing transaction costs and increasing liquidity in index Credit Default Swaps.¹⁹ While some other areas of the swaps market have slowed somewhat from pre-crisis numbers, those problems are rarely linked to regulation but instead are traceable to changes in the marketplace and market participants' appetite for risk.²⁰

The evidence reveals the same basic point across other markets. For example, in a recent letter to Treasury Secretary Steven Mnuchin, Senators Jeff Merkley and Sherrod Brown cautioned against another de-regulatory assault on the Volcker Rule, which bans risky and de-stabilizing proprietary trading by insured banking institutions. Attacks on the Volcker rule rest on the same false premise underlying Project KISS: regulation is stifling financial activity and economic growth. To rebut such arguments as to the Volcker rule, the Senators' letter cites the key role that proprietary trading played in crippling several large financial firms whose failure precipitated the worst financial crisis since the Great Depression. The letter also cites to hard evidence showing that banks are more profitable than ever and that loan levels are also robust and climbing:

There is little credible evidence that the Volcker Rule has harmed markets, or the economy. Preventing speculative bets has reduced volatility and, for those who have fully embraced its spirit of serving customers, has brought more, not less, stable profitability to the financial sector. The Volcker Rule is aimed at a goal that has broad support in Washington: focusing banks on making loans rather than risky proprietary bets. In that regard, it appears to be

¹⁵ Futures Industry Association, *Annual Volume Survey 2016* (Mar. 10, 2017) <http://marketvoicemag.org/?q=content/2016-annual-volume-survey> (emphasis added).

¹⁶ International Swaps and Derivatives Association, *SwapsInfo Second Quarter 2017 Review* at 2 (August 2017)

<https://www2.isda.org/attachment/OTU5MA==/Swaps%20review%20Q2%202017%20FINAL.pdf>.

¹⁷ *See id.* at 4.

¹⁸ *See id.* at 2.

¹⁹ Yee Cheng Loon and Zhaodong Zhong, *Does Dodd-Frank affect OTC Transaction Costs and Liquidity?*, 119 *J. of Finance and Economics* 645, 668 (2016).

²⁰ Sec. & Exch. Comm'n, Report to Congress on Access to Capital and Market Liquidity, at 246-47 (Aug. 2017), <https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf> (discussing the single-name Credit Default Swaps and explaining that various factors unrelated to regulation explain the mixed trends in liquidity and trading activity).

succeeding—in the first quarter of 2016, loans made by all federally insured institutions totaled \$8,939 billion, a 7.0% increase over 2015.^[8]

In fact, the Volcker Rule was implemented without compromising bank profits. The banking industry's annual profits reached record highs in 2016,^[9] when the industry's net income was \$171.3 billion, 4.9% more than in 2015.^[10] Ten of the nation's biggest lenders made \$30 billion in the second quarter of 2017, just a few hundred million short of the record in the second quarter of 2007.^[11] In 2017, the number of problem institutions, as defined by the Federal Deposit Insurance Corporation (FDIC), is down 88.12% since 2010.^[12] Profits were \$48.26 billion in the second quarter of 2017, up 10.72% from a year earlier.^[13] As of June 2017, 95.9% of all insured financial institutions are profitable according to reports from the FDIC.^[14]²¹

As to the criticism that regulation has impaired market liquidity, the evidence once again tells a different story. A case in point is a study that the Securities and Exchange Commission ("SEC") recently released finding no empirical evidence consistent with the hypothesis that liquidity in the U.S. Treasury markets has deteriorated after the Dodd-Frank Act regulatory reforms were put in place.²² The report reached a similar conclusion about the corporate bond market, observing that trading activity has increased since the reforms were adopted and that transaction costs have remained low or actually decreased.

Other analyses support these conclusions. A review of the metrics for market liquidity led to these findings by the Center for American Progress:

In testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs in April 2016, Antonio Weiss—counselor to Treasury Secretary Jack Lew—and Federal Reserve Board Governor Jerome Powell agreed that fixed-income markets, dominated by the markets for U.S. Treasury debt and U.S. corporate debt, are operating well and that no liquidity crisis exists. Kara

[8] "Statistics At A Glance," Federal Deposit Insurance Corporation, 31 March 2016, <https://www.fdic.gov/bank/statistical/stats/2016mar/industry.pdf>.

[9] Ryan Tracy, "U.S. Banking Industry Annual Profit Hit Record in 2016," *The Wall Street Journal*, 28 February 2017, <https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836>.

[10] Ibid.

[11] Yalman Onaran, "U.S. Mega Banks Are This Close to Breaking Their Profit Record," *Bloomberg Markets*, 21 July 2017, <https://www.bloomberg.com/news/articles/2017-07-21/bank-profits-near-pre-crisis-peak-in-u-s-despite-all-the-rules>.

[12] "Statistics At A Glance," Federal Deposit Insurance Corporation, 30 June 2017, <https://www.fdic.gov/bank/statistical/stats/>.

[13] Ibid.

[14] Ibid.

²¹ Letter from Jeff Merkley, Senator from Oregon, and Sherrod Brown, Senator from Ohio, to Steven Mnuchin, Secretary of the Treasury (Sept. 7, 2017) available at <https://www.merkley.senate.gov/news/press-releases/merkley-brown-raise-questions-about-new-attempt-to-weaken-volcker-rule> ("Merkley And Brown Letter").

²² Sec. & Exch. Comm'n, Report to Congress on Access to Capital and Market Liquidity (Aug. 2017), <https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf>.

Stein—commissioner of the Securities and Exchange Commission, or SEC—drew similar conclusions. . . .

With respect to the corporate bond market, research from the Federal Reserve Bank of New York, the Treasury Department, and the Financial Industry Regulatory Authority—a self-regulatory group for broker-dealers—finds little evidence that liquidity has deteriorated in the corporate bond market. In fact, by many metrics, the corporate bond market is more liquid now than it was before the crisis. Corporate bond issuance has been at all-time highs over the past several years. Investment-grade corporate bond issuance is up 7.5 percent year-to-date in 2016. Bid-ask spreads have been stable and are actually tighter than precrisis spreads. Trade size declined significantly during the crisis and still has not fully recovered, but the price impact of trades is well below precrisis levels. To put it simply, investors, especially in high-quality bonds, can trade the bonds they want to as cheaply as they ever have. As for securitizations and high-yield—sometimes called junk—bonds, regulators and market participants in recent years have been more concerned about a bubble from too many of these bonds, not illiquidity from too few bonds or limited trading. In short, an evidence-based approach shows that illiquidity is, at least to date, a phantom.²³

Even where the evidence suggests that liquidity in some markets may be fluctuating, experts observe that such changes are attributable to factors other than regulation. As the SEC report explained:

Evidence for the impact of regulatory reforms on market liquidity is mixed, with different measures of market liquidity showing different trends. Moreover, many of the observed changes in these measures are consistent with the combined impacts of several factors besides new rules and regulations, including, among others, electronification of markets, changes in macroeconomic conditions, and post-crisis changes in dealer risk preferences.²⁴

And as Fed Governor Powell observed: “It is important, however, not to overemphasize any effects of regulation. Banks have independently recalibrated their own approaches to risk and scaled back their market-making activities. Dealers significantly reduced their fixed-income portfolios beginning in 2009, well ahead of most post-crisis changes in regulation.”²⁵

²³ Andy Green & Gregg Glezins, *Phantom Illiquidity*, Center for American Progress (Nov. 15, 2016), <https://www.americanprogress.org/issues/economy/reports/2016/11/15/292313/phantom-illiquidity-a-closer-look-reveals-that-the-bond-markets-are-functioning-well/> (citations omitted).

²⁴ Sec. & Exch. Comm’n, Report to Congress on Access to Capital and Market Liquidity, at 6 (Aug. 2017) <https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf>.

²⁵ *Examining Current Trends And Changes In The Fixed-Income Markets: Joint Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 114 Cong. 33-34 (2016) (statement of Jerome Powell, Fed. Res. Gov.); see also Stanley Fischer, Vice Chair of the Fed. Res., “Is there a Liquidity Problem Post-Crisis?”

Even if liquidity may have actually undergone changes in some markets due to regulation, such effects are a small price to pay for greater financial stability. Furthermore, they are bound to be short-lived as the markets adapt and any genuine demand for more liquidity triggers innovation that satisfies the need. Governor Powell explained these points as follows:

[P]ost-crisis regulations have also greatly strengthened the major banks and made another financial crisis far less likely. Evidence also indicates that certain regulations have increased liquidity; for example, the mandate that more standardized derivatives be traded on organized exchanges or platforms appears to have improved market functioning That said, we should also recognize that some reduction in market liquidity is a cost worth paying in helping to make the overall financial system significantly safer. . . . Where there is an unmet demand for liquidity, new market makers are emerging to meet that demand. For example, some PTFs are seeking entry to dealer-to-customer platforms for Treasury trading. Seven new electronic trading venues entered the market for corporate and municipal bonds over the last two years, and several more are preparing to launch this year. While there is no guarantee of success for these entrants, markets will continue to evolve. Thus, it is too early to judge the ultimate impact of factors affecting fixed-income liquidity.²⁶

As shown by the data and analyses provided by these authoritative sources, proponents of de-regulation have failed to make a credible case that regulation is hampering our financial markets or stifling economic growth and prosperity. In fact, a review of the recent evidence shows just the opposite: strong financial regulation has created the investor confidence and long-term stability that are enabling our markets to thrive and our economy to continue growing.²⁷

(Nov. 15, 2016), at 4-9 (citing evidence, including low trading costs and high trading volume in the corporate bond market, that liquidity is at healthy levels, and suggesting that even if regulations have some impact on liquidity, the increased financial stability created by those regulations outweighs any liquidity effects), <https://www.federalreserve.gov/newsevents/speech/fischer20161115a.htm>.

²⁶ *Examining Current Trends And Changes In The Fixed-Income Markets: Joint Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 114 Cong. 33-34 (2016) (statement of Jerome Powell, Fed. Res. Gov.); see also Stanley Fischer, Vice Chair of the Fed. Res., “Is there a Liquidity Problem Post-Crisis?” (Nov. 15, 2016), at 2 (indicating that hedge funds and insurance companies may supply liquidity to the extent primary dealers reduce participation).

²⁷ Just in its title, Project KISS conveys the implicit but erroneous impression that the CFTC’s derivatives regulations are needlessly complex. However, by virtue of the complexities inherent in the derivatives markets, the mandates of the Dodd-Frank Act, the relentless lobbying by industry for changes and exceptions in the rules, and the need to guard against loopholes that would effectively nullify the rules, the CFTC’s derivatives regulations must of necessity be complex.

II. Project KISS turns a blind eye to the threat of another crisis.

De-regulation threatens to set the stage for another cycle of high-risk, short-sighted financial activities that precipitate another financial crisis. The Commission seems to think that it can foster economic growth by watering down its regulations. Quite the opposite is true. Diluting regulation leads to financial crisis, and financial crisis in turn does far more to destroy financial markets and economic prosperity than any set of rules and regulations possibly can.

The unregulated swaps markets were at the heart of the 2008 financial crisis, and the reforms in Title VII of the Dodd-Frank Act were among the most important that Congress adopted. For example, the swaps data reporting requirements are a key component, and they play a critical role in maintaining open, competitive, and more stable markets. As we explained in one of our earlier comment letters:

The financial markets are founded on information: who owes what to whom, when, and under what circumstances. However, the financial crisis demonstrated that the swaps markets had no functional system to keep track of the mountain of transaction and accounting data. It was this lack of transparency and understanding of the vast network of swap exposures that fueled the tremendous panic around the global financial crisis and frustrated any regulatory efforts to contain or mitigate it.²⁸

The regulation of these important markets must remain strong, not return to the days when oversight was non-existent or weak.

The perils of de-regulating our financial markets, including derivatives specifically, are the subject of long-standing and increasing alarm. In the midst of the crisis, a New York Times editorial tied the threat of financial crises specifically to the need for **more** oversight and transparency in the derivatives markets, not less:

De-regulation led to the financial crash of 2008. It's safe to assume that repeating the mistake will lead to the same result. . . . It's entirely possible that the system is more fragile than the Fed's stress tests indicate. . . . The difference is largely attributable to regulators' differing assessment of the risks posed by derivatives, the complex instruments that blew up in the financial crisis and that still are a major part of the holdings of big American banks. . . . But without continued bank regulation, and heightened vigilance of derivatives, in particular, the good fortune of bank investors and bank executives is all too likely to come at the expense of most Americans, who do

²⁸ Better Markets, Inc., Comment Letter on Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, (Oct. 30, 2015) *available at* <https://bettermarkets.com/rulemaking/better-markets-comment-letter-cftc-sdr-rules>.

not share in bank profits but suffer severe and often irreversible setbacks when deregulation leads to a bust.²⁹

More broadly, Federal Reserve Vice Chair Stanley Fischer opposed calls for looser capital and liquidity requirements on banks with these warnings:

I am worried that the US political system may be taking us in a direction that is very dangerous It took almost 80 years after 1930 to have another financial crisis that could have been of that magnitude. And now, after 10 years everybody wants to go back to a status quo before the great financial crisis. And I find that really, extremely dangerous and extremely short-sighted.³⁰

And as Thomas Hoenig, Vice Chairman of the FDIC, recently explained in a letter to the leadership of the Senate Banking Committee, “I can only caution against relaxing current capital requirements and allowing the largest banks to increase their already highly leveraged positions. **The real economy has little to gain, and much to lose, by doing so.**”³¹

De-regulation threatens not only the stability and transparency of our financial markets, but also investor protection. Reuters recently reported that “retail currency brokers are considering operating in the United States after a nearly seven-year absence, if President Trump is able to carry through on his pledge to deregulate the financial markets. . . . Key players in the vast retail market are gearing up for a hopeful re-entry.” This is alarming because the so-called FX market, which is overseen by the Commission, has an infamous history as a breeding ground for fraudulent schemes that inflicted huge losses on countless individual retail investors. The Commission knows this full well, as it battled against these illegal enterprises for decades. De-regulation means open season once again on investors.

The costs of the 2008 financial crisis have been well-documented, with conservative estimates showing that it destroyed at least \$20 trillion in gross domestic product.³² In more human terms, it threw millions of Americans into long-term unemployment or underemployment, cast over 15 million homes into foreclosure, and obliterated \$19 trillion in wealth, including retirement savings.³³ That economic destruction and all that comes

²⁹ R. M. Schneiderman, Did Deregulation Cause the Credit Crisis?, New York Times, (Oct. 8, 2008) <https://economix.blogs.nytimes.com/2008/10/08/did-deregulation-cause-the-credit-crisis/?mcubz=0>.

³⁰ Abhinav Ramnarayan, *Fed's Fischer Says Move to Unwind Bank Regulation 'Dangerous,'* Reuters (Aug. 17, 2017), <https://www.reuters.com/article/us-usa-fed-fischer-idUSKCN1AX0PK>.

³¹ Letter from Thomas Hoenig to the Leadership of the Senate Banking Committee, (July 31, 2017) <https://www.fdic.gov/about/learn/board/hoenig/hoenigletter07-31-2017.pdf> (emphasis added).

³² Better Markets, The Cost of Crisis, \$20 Trillion and counting (July, 2015), available at <https://www.bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf>.

³³ *Id.*

with it is what we can expect if the de-regulatory agenda of the new Administration takes hold at the Commission and the other financial regulatory agencies.³⁴

III. If the Commission seeks to change its rules or policies pursuant to the KISS initiative, it must adhere to the letter and spirit of the Commodity Exchange Act as well as the procedural mandates of the Administrative Procedure Act.

A. Throughout Project Kiss, the Commission must adhere to its organic statute and seek to fulfill its underlying purposes.

As the Commission moves forward with Project KISS and considers modifying its regulations in substance or in application, it must always abide by the Commodity Exchange Act, as amended by the Dodd-Frank Act. Moreover, the Commission must strive to effectuate the underlying remedial purposes of both laws. That means wherever possible, it must enhance the regulations rather than diluting them in the name of streamlining requirements and minimizing industry costs.

The Commodity Exchange Act is focused on serving the public interest by preserving fair markets, protecting market participants from fraud and abuse, and promoting fair competition. Congress stated explicitly that it created the Commission—

to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.³⁵

And in prescribing the factors that the Commission must consider when promulgating rules, Congress was also focused on public interest values:

- (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.³⁶

³⁴ Ironically, Chairman Giancarlo's March 15th speech repeatedly and appropriately acknowledged the enormity of the crisis and its long-term impact: "And yet, it has taken a long time – too long – for many American companies and citizens to emerge from the recession Too many Americans have been left out of a tepid recovery." Remarks at 2. The answer to this state of affairs cannot reasonably be the type of de-regulation that led to the crisis in the first place.

³⁵ 7 U.S.C. § 5 (2012).

³⁶ 7 U.S.C. § 19(a)(2) (2012).

Similarly, the Dodd-Frank Act was passed above all “to provide for regulatory reform, to protect consumers and investors, to enhance Federal understanding of insurance issues, **to regulate the over-the-counter derivatives markets**, and for other purposes”³⁷

The Senate Report also reflects the thoroughly protective aims of the law and the goal of **creating** new regulatory structures, not **removing** regulation.

The Committee on Banking, Housing, and Urban Affairs, having considered the original bill (S. 3217) to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end “too big to fail”, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.³⁸

Elsewhere, the Senate Report focuses specifically on the need for comprehensive regulation of the derivatives markets, including critical improvements in the transparency of those markets:

According to the Obama Administration, “the downside of this lax regulatory regime . . . became disastrously clear during the recent financial crisis . . . many institutions and investors had substantial positions in credit default swaps—particularly tied to asset backed securities . . . excessive risk taking by AIG and certain monoline insurance companies that provided protection against declines in the value of such asset backed securities, as well as poor counterparty credit risk management by many banks, saddled our financial system with an enormous—and largely unrecognized—level of risk.” “[T]he sheer volume of these contracts overwhelmed some firms that had promised to provide payment on the CDS and left institutions with losses that they believed they had been protected against. Lacking authority to regulate the OTC derivatives market, regulators were unable to identify or mitigate the enormous systemic threat that had developed.” OTC contracts can be more flexible than standardized contracts, but they suffer from greater counterparty and operational risks and less transparency. Information on prices and quantities is opaque. This can lead to inefficient pricing and risk assessment for derivatives users and leave regulators ill-informed about risks building up throughout the financial system. Lack of transparency in the massive OTC market intensified systemic fears during the crisis about interrelated

³⁷ Conference Report, Dodd-Frank Wall Street Reform and Consumer Protection Act, Rep. No. 111-517, 111th Cong. 2d Sess. (June 29, 2010), at preamble.

³⁸ Senate Report, The Restoring American Financial Stability Act of 2010, Rep. No. 111-176, 111th Cong. 2nd Sess. (Apr. 30, 2010), at preamble.

derivatives exposures from counterparty risk. These counterparty risk concerns played an important role in freezing up credit markets around the failures of Bear Stearns, AIG, and Lehman Brothers.³⁹

As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole.⁴⁰

And even the exemptive authority of the Commission is bounded by the public interest: “The Commission may grant exemptions to futures market participants only if it finds the exemptions are in the public interest.”⁴¹

Nowhere in these guides to Congress’s intent is there a concern for protecting the profits of banking entities, sparing them compliance costs, or otherwise accommodating their preferences in a regulatory model. Any changes to the Commission’s rules or practices that cannot be reconciled with the statutory provisions of the Commodity Exchange Act and the Dodd-Frank Act and their protective purposes must be rejected.

B. The Commission must provide a legally sufficient explanation for any rule changes, in accordance with the APA, including, if possible, a credible factual basis for changing its regulatory approach.

The law clearly provides that while an agency may reconsider its rules and ultimately change them, it must nevertheless adhere to the requirements established under the APA that govern all rulemaking. At a minimum, and as always, the agency must examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choices made.⁴² With respect to changes in rules, the agency must demonstrate that the new approach is consistent with its organic statute, that the agency has good reasons for any changes, and that the agency believes it to be better.⁴³ And when an agency decides to adopt a new regulatory policy that “rests upon factual findings that contradict those which underlay its prior policy,” the agency has a specific duty to supply a reasoned explanation for “disregarding facts and circumstances that underlay the prior policy.”⁴⁴

³⁹ *Id.* at 29-30.

⁴⁰ *Id.* at 32.

⁴¹ 7 U.S.C. § 5 (2012).

⁴² *See Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983).

⁴³ *See Fed. Communication Comm’n v. Fox*, 556 U.S. 502, 515 (2009).

⁴⁴ *Id.* at 516.

The Commission must be prepared to satisfy these requirements. And as the Commission reviews the wave of comments and submissions from market participants seeking to justify changes in rules on factual grounds, it must weed out and discount any proffered “evidence” in the form of biased, industry-bought studies. In fact, the hallmarks of financial industry lobbying against financial regulations are dire, sky-is-falling predictions that our markets, our economy, and our overall prosperity will suffer terribly if rules designed to protect the public interest are put in place. Invariably, those predictions have little concrete support and prove to be false.

At this point in time, and without reviewing any specific proposals for change that may emerge from Project KISS, it is impossible to assess whether the Commission will violate these regulatory requirements. However, it is fair to say that weakening the Commission’s rules purely to afford market participants relief from compliance costs or out of concern for maximizing their revenues and profits would not be consistent with these precepts.

C. The Commission must adhere to the APA notice and comment process, and must not attempt to skirt those requirements by issuing new rules under the rubric of mere guidance.

The RFI states that it is not asking the public to identify rules for modification or repeal.⁴⁵ Instead, its stated goal is to solicit input about how the Commission’s rules could be “applied in a simpler, less burdensome, and less costly manner.”⁴⁶ Presumably, this means that in response to comments, the Commission may issue new guidance, interpretive rules, or policy statements to change the way it implements or applies its existing rules. If the Commission follows this path, it must take care not to propose de facto substantive rule changes in the guise of less official policy statements or similar pronouncements. And even where it seeks to implement truly technical and non-substantive requirements, it should engage in a fully transparent process, including notice and comment.

The path chosen between rules and guidance can make an enormous difference from a regulatory process standpoint. In general, the nature of an agency’s action determines the extent to which that action is subject to—

- notice and comment procedures under the APA;
- the obligation to conduct cost-benefit analysis;
- judicial review as final agency action; and
- the application of *Chevron* deference in the event of a court challenge.⁴⁷

⁴⁵ RFI at 23766.

⁴⁶ RFI at 23765.

⁴⁷ See *Securities Industry & Financial Markets Ass’n v. Commodity Futures Trading Comm’n*, 67 F. Supp. 3d 373, 412 (D.D.C. 2014) (holding that the Commission’s cross-border guidance was not a legislative rule and therefore was not final agency action subject to judicial review); see also 5 U.S.C. § 553 (notice and comment requirements of the APA are not applicable to “interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice”).

When identifying the nature of an agency action, courts do not blindly accept the characterization supplied by the agency, but instead apply a factors analysis to determine the essential nature of the action. More important than the agency's own label is "the actual legal effect (or lack thereof) of the agency's action."⁴⁸ And the courts will guard against attempts by an agency to avoid the APA rulemaking requirements by engaging in a "charade, intended to keep the proceduralizing courts at bay."⁴⁹ The Commission must bear these principles in mind as it decides whether and how to change the way it implements its rules.

Finally, regardless of what changes the Commissions may decide to make in the way it applies existing rules, it should adhere to the procedural requirements contemplated under the APA. That includes, without limitation, giving advance notice of any such changes, articulating the basis for them, and providing a meaningful opportunity for all stakeholders to submit their views.

CONCLUSION

We hope these comments are helpful as you consider changes to the Commission's rules or modifications to the way they are applied.

Sincerely,



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⁴⁸ *Id.* at 416 (quoted authorities omitted).

⁴⁹ *Appalachian Power Co. v. EPA*, 208 F. 3d 1015, 123 (D.C. Cir. 2000).