

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

April 8, 2013

Memorandum

To: Members, Committee on Financial Services

From: Committee Staff

Subject: Subcommittee on Capital Markets and Government Sponsored Enterprises
Hearing on “Legislative Proposals Regarding Derivatives and SEC Economic Analysis”

The Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on “Legislative Proposals Regarding Derivatives and SEC Economic Analysis,” at 10 a.m. on Thursday April 11, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- The Honorable Kenneth E. Bentsen, Jr., Acting President and CEO, Securities Industry and Financial Markets Association
- Christopher Childs, Chief Executive Officer, Depository Trust & Clearing Corporation Data Repository (U.S.)
- Thomas Deas, Vice President and Treasurer, FMC Corporation, on behalf of the Coalition of Derivatives End Users
- Dr. John E. Parsons, Sloan School of Management, Massachusetts Institute of Technology

Legislation

The legislative proposals that will be examined at the hearing are:

- H.R. 634, the Business Risk Mitigation and Price Stabilization Act of 2013
- H.R. 677, the Inter-Affiliate Swap Clarification Act
- H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013
- H.R. 992, the Swaps Regulatory Improvement Act
- H.R. 1062, the SEC Regulatory Accountability Act
- H.R. 1256, the Swap Jurisdiction Certainty Act
- H.R. 1341, the Financial Competitive Act of 2013

H.R. 634, “The Business Risk Mitigation and Price Stabilization Act of 2013”

H.R. 634, the Business Risk Mitigation and Price Stability Act of 2013, introduced by Reps. Michael Grimm, Gary Peters, Austin Scott and Mike McIntyre, would exempt end-users from the margin and capital requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203). During consideration of the Dodd-Frank Act, a colloquy among the chairmen of the four committees with primary jurisdiction over Title VII (Senators Dodd and Lincoln and Representatives Frank and Peterson) clarified Congress’s intent that the Dodd-Frank Act did not grant regulators the authority to impose margin requirements for end-user transactions. Notwithstanding this expression of Congressional intent, some regulators have interpreted Title VII as granting them the authority to impose margin requirements on end-users merely because they are counterparties to swaps with a regulated entity, such as a swap dealer or financial institution.

In the 112th Congress, Reps. Grimm and Peters introduced the same bill (H.R. 2682), which passed the Committee by voice vote on November 30, 2011, and passed the House by a vote of 370-24 on March 26, 2012.

In the 113th Congress, the Committee on Agriculture reported the legislation favorably to the House of Representatives by voice vote on March 20, 2013.

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

H.R. 677, the Inter-Affiliate Swap Clarification Act, introduced by Reps. Steve Stivers, Marcia Fudge, Chris Gibson and Gwen Moore, would exempt inter-affiliate trades from the Dodd-Frank Act’s margin, clearing, and reporting requirements. Inter-affiliate swaps are swaps executed between entities under common corporate ownership. Inter-affiliate swaps allow a corporate group with subsidiaries and affiliates to better manage risk by transferring the risk of its affiliates to a single affiliate and then executing swaps through that affiliate. Inter-affiliate swaps do not create additional counterparty exposures or increase the interconnectedness between parties outside the corporate group; nonetheless, the Dodd-Frank Act subjects inter-affiliate swaps to the same requirements as swaps between unrelated parties.

In the 112th Congress, Reps. Stivers and Fudge introduced a similar bill (H.R. 2779), which passed the Committee (as amended) by a vote of 53 yeas and 0 nays on November 30, 2011. The House passed H.R. 2779 by a vote of 357 yeas and 36 nays on March 26, 2012.

In the 113th Congress, the Committee on Agriculture reported the legislation favorably to the House of Representatives by voice vote on March 20, 2013.

H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013

H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Act of 2013, introduced by Reps. Rick Crawford, Sean Patrick Maloney, Bill Huizenga and Gwen Moore, would remove an indemnification requirement imposed on foreign regulators by the Dodd-

Frank Act as a condition of obtaining access to data repositories. Sections 728 and 763 of the Dodd-Frank Act require swap data repositories and security-based swap data repositories to make data available to non-U.S. financial regulators, including foreign financial supervisors, foreign central banks, and foreign ministries. Before a U.S. data repository can share data with a foreign regulator, however, the foreign regulator must agree that it will abide by applicable confidentiality requirements and that it will indemnify the data repository and the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC) for litigation expenses that may result from the sharing of data with the foreign regulator. Section 725 imposes similar requirements for data sharing between derivatives clearing organizations and foreign regulators, including the requirement that foreign regulators indemnify derivatives clearing organizations and U.S. regulators for litigation expenses that may result from the sharing of data with foreign regulators.

These indemnification provisions threaten to make data sharing arrangements with foreign regulators unworkable. On February 1, 2012, the CFTC and the SEC staff issued a “Joint Report on International Swap Regulation,” which highlighted problems arising from the indemnification provisions in Sections 728 and 763. The Commissions’ staff reported that the indemnification provisions have “caused concern among foreign regulators, some of which have expressed unwillingness to register or recognize [a swaps data repository] unless able to have direct access to necessary information.” The staff noted that “Congress may determine that a legislative amendment to the indemnification provision is appropriate.”

In the 112th Congress, Reps. Robert Dold and Gwen Moore introduced a similar bill (H.R. 4235), which passed the Committee (as amended) by voice vote on March 27, 2012.

In the 113th Congress, the Committee on Agriculture reported the legislation favorably to the House of Representatives by voice vote on March 20, 2013.

H.R. 992, the Swaps Regulatory Improvement Act

H.R. 992, the Swaps Regulatory Improvement Act, introduced by Reps. Randy Hultgren, James Himes, Richard Hudson and Sean Patrick Maloney, would repeal most of Section 716 of the Dodd-Frank Act. Section 716 prohibits “federal assistance”—defined as “the use of any advances from any Federal Reserve credit facility or discount window . . . [or] Federal Deposit Insurance Corporation insurance or guarantees”—to “swaps entities,” which include swap dealers and major swap participants, securities and futures exchanges, swap-execution facilities, and clearing organizations. Section 716—known as the swap desk “push out” or “spin off” provision—forces financial institutions that have swap desks to move them into an affiliate to preserve their access to Federal Reserve credit facilities and federal deposit insurance. Although the provision allows banks to continue dealing in swaps related to interest rates, foreign currency, and swaps permitted under the National Bank Act, they are prohibited from engaging in swaps related to commodities, equities, and credit.

Rather than making the financial system more stable, Section 716 appears to have made it more fragile. Federal Reserve Board Chairman Ben Bernanke has noted that

Section 716 “would make the U.S. financial system less resilient and more susceptible to systemic risk” because “forcing [commercial and hedging activities] out of insured depository institutions would weaken both financial stability and strong prudential regulation.”¹ To address this unintended consequence, H.R. 992 would repeal all of Section 716 except subsection (i), which prohibits the use of taxpayer funds to bail out swaps entities.

In the 112th Congress, Rep. Nan Hayworth introduced a similar bill (H.R. 1838), which passed the Committee (as amended) by voice vote on February 16, 2012.

In the 113th Congress, the Committee on Agriculture reported the legislation favorably to the House of Representatives by a roll call vote of 31-14 on March 20, 2013.

H.R. 1062, the SEC Regulatory Accountability Act

H.R. 1062, the SEC Regulatory Accountability Act, introduced by Capital Markets Subcommittee Chairman Scott Garrett, would direct the SEC to follow President Obama’s Executive Order No. 13563, which requires government agencies to conduct cost-benefit analyses to ensure that the benefits of any rulemaking outweigh the costs. The Executive Order also requires that regulations be accessible, consistent, written in plain language, and easy to understand. Because the SEC is an independent agency, it is not required to follow the Executive Order. Former SEC Chairman Schapiro indicated that the SEC will abide by the Executive Order. This bill codifies the Executive Order, mandating by statute that the SEC conduct cost-benefit analyses rather than leaving the decision to comply with the Executive Order to the discretion of the SEC’s Chairman. H.R. 1062 requires the SEC to identify the problem to be addressed by a proposed regulation and to assess the significance of that problem before the SEC issues a rule. The legislation requires the SEC’s Chief Economist to conduct a cost-benefit analysis of potential rules to ensure that the burdens on economic growth and job creation from a proposed regulation do not outweigh the benefit of the regulation.

In the 112th Congress, Chairman Garrett introduced a similar bill (H.R. 2308), which passed the Committee by a vote of 30 yeas and 26 nays on February 16, 2012.

H.R. 1256, the Swap Jurisdiction Certainty Act

H.R. 1256, the Swap Jurisdiction Certainty Act, introduced by Reps. Scott Garrett, John Carney, Michael Conaway and David Scott, would require the SEC and CFTC to jointly issue rules relating to swaps transacted between U.S. persons and non-U.S. persons. H.R. 1256 would also exempt a non-U.S. person in compliance with the swaps regulatory requirements of a G20 member nation from U.S. swaps requirements unless the SEC and CFTC jointly determine that the regulatory requirements are not “broadly equivalent” to U.S. swaps requirements.

¹ Letter from Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, to Senator Chris Dodd (May 12, 2010), available online <http://blogs.wsj.com/economics/2010/05/13/bernanke-letter-to-lawmakers-on-swaps-spin-off/>

Title VII of the Dodd-Frank Act seeks to regulate the over-the-counter derivatives (OTC) market similar to the way that equities and futures exchanges are regulated. Because the OTC market is global, Title VII raises questions about the extent to which U.S. regulations will apply to swap and security-based swap transactions that take place outside the U.S. Title VII's plain language makes clear that Congress intended it to apply outside the U.S. only in certain limited circumstances. Section 722 directs that provisions relating to swaps will not apply to activities outside the U.S. unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) contravene anti-evasion rules promulgated by the CFTC. The comments and actions of U.S. regulators indicate that they are considering regulations that would result in Title VII being applied more broadly than Congress intended. Further, the Dodd-Frank Act requires both the CFTC and the SEC to issue rules on the extraterritorial scope of Title VII, creating the possibility of two different, potentially conflicting, regulatory regimes.

In the 112th Congress, Rep. Himes introduced a similar bill (H.R. 3283). While H.R. 3283 bill dealt with the extraterritorial scope of Title VII, it was also more prescriptive than H.R. 1256, defining "U.S. person," "non-U.S. person," and setting forth the circumstances in which Title VII would apply to non-U.S. financial institutions and transactions. H.R. 3283 passed the Committee by a vote of 41 yeas and 18 nays on March 27, 2012.

In the 113th Congress, the Committee on Agriculture reported the legislation favorably to the House of Representatives by voice vote on March 20, 2013.

H.R. 1341, the Financial Competitive Act of 2013

H.R. 1341, the Financial Competitive Act of 2013, introduced by Rep. Stephen Fincher, requires the Financial Stability Oversight Council (FSOC) to study the likely effects of the differences between the U.S. and other jurisdictions in implementing the derivatives credit valuation adjustment (CVA) capital requirement. The Capital Requirements Directive IV package, announced by the European Union on February 28, 2013, includes the CVA requirement and Basel III, which will implement internationally agreed-upon standards on capital and liquidity across the European Union. Derivatives transactions with sovereign, pension fund and corporate counterparties (which are exempt from clearing obligations) will be exempt from the CVA. The EU CVA exemption has raised concerns that there will not be global derivatives regulatory alignment and that the CVA exemption could impact the pricing of trades and the amount of liquidity available for non-financial U.S. derivative end-users, as their transactions would not receive the CVA exemption. The FSOC study is due within 90 days of enactment to the Chairman and Ranking Members of the Committees on Agriculture and Financial Services of the House of Representatives, as well as the Chairman and Ranking Members of the Committees on Agriculture, Nutrition and Forestry and Banking, Housing and Urban Affairs of the Senate.

On March 20, 2013, Rep. Fincher offered and withdrew H.R. 1341 as an amendment to H.R. 634 during the Committee on Agriculture's full Committee markup.