The Derivative Project

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Via Electronic Submissions

Office of the Comptroller of the Currency

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RE: 'Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds''

The Derivative Project appreciates the opportunity to submit comments on the proposed "Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds,"

Further, The Derivative Project submits these comments for:

The Staff of the Commodity Futures Trading Commission (CFTC) who will hold a public roundtable to discuss the proposed regulations to implement Section 619 (commonly known as the Volcker Rule) of the Dodd-Frank Wall Street Reform and Consumer Protection Act on May 31, 2012.

These comments are strictly focused on a request that you re-examine the intersection of the over-the-counter markets, for derivatives and repurchase agreements and their utility in relation to regulated futures exchanges, as a more cost-effective market for speculators.

We urge you to simply the proposed regulation, comparable to the simplicity of Glass-Steagall, with the consideration of a fundamental restructuring of the current roles of the futures markets and over-the-counter markets, on behalf of every U.S. taxpayer. We respectfully request the CFTC and the SEC simultaneously provide a cost benefit analysis to the taxpayer of the costs and benefits of moving a significant percentage of OTC derivative trades to regulated futures exchanges, eliminating the potential threat of failures of newly proposed clearinghouses for OTC derivatives. This proposal will cut into the existing profit models of these market makers, but the costs to the taxpayer appear intuitively to out weigh the benefit to the U.S. taxpayer of the CFTC and the SEC not examining the social utility of this proposal.

As a former over-the-counter (OTC) derivative corporate foreign currency trader, I worked with end users on cost-effective hedges for transactional and translational currency exposures, both through netting and forward, swap and option OTC foreign currency contracts, including foreign currency based loans.

Further, as a counter-party credit risk analyst on the determination of limits on a U.S. Bank's credit exposures to a given counterparty, including loans and derivative exposures, by entity, in the early 1980's, I have followed the evolution of the risk management protocol, prior to the conventional usage of VaR in the over-the-counter markets.

Thus, my perspective is simplistic, straight –forward, but in the best interest of U.S. taxpayers. I seek to provide a simple explanation that voters can use to lobby their Congressional representative on or vote out in the instance of failure to act in the public interest.

It is clear Dodd Frank has not addressed the simple issues that are in the public interest. Recent billion dollar speculative losses on the sale of credit default swaps by JP Morgan and the collapse of MF Global and the taking of farmers' margin is cause for an immediate, drastic change to the status quo, which is Wall Street lobbyists dictating the agenda in the over-the-counter derivative markets or repo markets to ensure their profit model may continue despite significant social costs.

The Volcker Rule is Well Intended Banning Proprietary Trading, But Another Solution Provides Less Regulatory Costs to Regional Banks and U. S. Taxpayers

From a public interest standpoint, in simple language, the allure of easy profits in the over-the-counter markets cannot be controlled by complex, intertwining regulation, as proposed by Dodd-Frank, based on the nature of the over-the-counter markets as they originally evolved and were intended as an "inter-bank" market. The introduction of non-commercial bank entities, such as hedge funds, investment banks, large oil and agricultural organizations and "mutual funds" in the traditional inter-bank market, using the over-the-counter markets for speculative purposes, in lieu of bona fide hedge purposes or market making for their clients, marked the evolution of three problematic scenarios that Dodd Frank does not address:

- Speculation without regard to common sense counterparty credit risk management, as evidence by the $180 billion taxpayer AIG bailout and more recently, the MF Global bankruptcy and loss of farmers margin

- The rapidly escalating use of over-the-counter derivative markets for speculation, disguised as end user trades, in lieu of bona fide proprietary trading by the "inter-bank" commercial banking market for their "end user" clientele, as evidenced by J.P. Morgan's credit default swap trade on a CDS Index, which is estimated to cause losses from $3 billion to $7 billion.

- Speculation, with excessive leverage, and the allure of profits from position taking that is only possible in markets that do not require mark to market collateral on a daily basis.

In short, the over-the-counter derivative inter-bank markets were based on trust. That trust is broken and cannot be restored. There is no second chance as the risks to our financial system and society overall are too great. These markets must be fundamentally altered, in conjunction with changes to the organized futures markets.

The significant impairment of the U.S. economy, high unemployment, loss of retirees' savings, collapse of the housing market, in part due to derivatives embedded in mortgage products, necessitates a fundamental reorganization of the over-the-counter derivative markets. We urge you to consider an end to the use of OTC contracts for speculative purposes, with the exception of commercial banks defined "market-making" role, in a newly revamped, highly regulated inter-bank market, that file daily reports on end user amounts that exceed a certain amount as established by the CFTC, FDIC and the Board of Governors of the Federal Reserve Bank and a public panel, yet to be determined.

Commercial banks, traditionally trained in credit risk management, once had a defined protocol for counter party credit risk management that is lacking at hedge funds and mutual funds. How else could one define the phenomenal credit exposures taken on in the over-the-counter derivative markets by non-commercial banks, such as AIG, Lehman Brothers, Goldman Sachs and Morgan Stanley, that led to tax-payer bailouts resulting from excessive AIG exposures and lack of common sense counter party credit risk management, not to mention questionable underlying assets that the derivative trades were based on?

Therefore, we recommend a return to a controlled “inter-bank” market, over-the-counter derivative market, which will allow proprietary trading solely for commercial banks to meet end user hedging needs. Hedge funds and mutual funds would be clients of the commercial banks, as end-users, solely if they have a bona fide hedging need.

The trust of commercial banks must be restored, as they are the foundation of our capital markets. We must believe they will act in society’s best interest. Commercial banks will once again act on the honor system and proprietary trading will be solely to effect bona fide hedges for legitimate end users. In essence, it is a return to Glass Steagall.

All Speculative Trades Would move From OTC Markets to Regulated Exchanges

If mutual funds, large energy and agricultural firms and hedge funds seek to speculate in derivative markets, these actions would be processed where speculative trades have been processed for centuries, on regulated exchanges with daily mark to market margin postings. Farmers’ bona fide hedges should not be at a disadvantage to other end users, with their requirement to post daily margin, dependent on mark to market. The Volcker Rule should seek to even the playing field for farmers and other end users. Speculators would be required to post collateral, in every instance.

As one regional bank publicly commented on this proposed rule, the proposed rule making necessitates new procedures that are too costly for their bona fide business to meet their clients’ hedging needs. The Volcker Rule should not penalize regional bank’s market making activities for their clients.

Dodd-Frank Regulatory Costs, as proposed, are Too High for the U.S. Taxpayer and Must Be Reigned in by More Simplistic Rule Making

The taxpayer - funded regulatory costs to monitor over-the-counter derivative trades by non-commercial bank entities are staggering and provide no societal value and sustainable growth in GDP. The systemic risks presented by non-transparent counter parties, other than Federally regulated commercial banks, overseen by one regulator are staggering.

Over-the-counter derivative markets’ sole purpose should be designed to meet end-user hedging needs. All speculation, other than by commercial bank entities must be conducted on regulated exchanges, with mark to market collateral. The CFTC will be responsible for the ongoing setting of appropriate position limits for futures contracts.

In reading the comments from the energy industry and the investment banks, it is apparent the over-the-counter markets have become a significant source of speculative profits, without posting of collateral, such as the case with Berkshire Hathaway’s multi-billion uncollateralized equity derivative position, that is on the books until 2018.

Thus, society is absorbing the risk, without compensating benefits or reimbursement for regulatory costs. The Office of the Comptroller of the Currency graph that depicts the growth of speculative trading in these markets from 1996 to present will not stop its phenomenal rate of growth if over-the-counter markets continue as currently structured.

The annual increase in OTC speculative trading is staggering. The profit model, speculation without collateral costs, is just too compelling for entities to abandon without a fight. This is clearly an unnecessary advantage for one sector over another. The playing field must be leveled, as the taking of farmer's segregated margin in the MF Global case has clearly demonstrated.

Ban Product Innovation with Derivatives Until Firms Pay Requisite Costs to Hire Experienced OTC Market Participants that Can Analyze the Product Usefulness in an Unbiased Fashion for Investors and Fiduciaries

Problematic products, such as credit default swaps embedded in mortgage backed securities or structured notes, or other new "innovative" products must be banned until there is a "sales force" and/or asset managers that are properly trained to analyze these products, their application and their usefulness, as determined by the SEC and a newly created "Public Panel", independent of Wall Street's lobbyists.

Series 7 brokers are not currently trained on derivative products and are incapable of analyzing their risks, due to lack of experience and mandatory training. The SEC and FINRA have not insisted that fiduciaries or brokers that are involved with analyzing derivative have any direct knowledge and experience. It is quite possible if fiduciaries, asset managers and all SEC registered investment advisors had been trained and experienced in the day-to-day operation of the OTC derivative markets, over $2 trillion dollars over retirement dollars would not have been lost during the 2008-20009 financial crisis.

Yes, very few asset managers or pension managers have had day-to-day experience with over-the-counter derivatives. Thus, the "engineers" of these products may very easily sell a bill of goods to American's pension funds, trust account fiduciaries and asset managers of 401K assets, that is speculative and inappropriate. This has been the plea from many Counties from France, to Italy to Jefferson County, Alabama-- to non-profits that lost millions on Charles Schwab's High Yield fund. " We were told the product was in our best interest," yet it caused billions of dollars of losses, many times because the sales force did not act as a fiduciary or was not trained and experienced in the derivatives embedded in the product offering.

Maintaining over-the-counter derivative markets for speculation cannot be the status quo. A reorganization of regulated futures markets and clearly specified and defined uses of the OTC derivative markets must occur, in conjunction with portions of the Volcker Rule.

We propose that the SEC, CFTC, Board of Governors of the Federal Reserve, SEC, FDIC, and Office of the Comptroller of the Currency focus on common sense solutions that are in the best interest of the U.S. taxpayer, that will minimize taxpayer funded regulatory costs. We urge them to focus on the most cost effective regulatory solution**,** which is to eliminate speculation without collateral postings on a mark to market, daily basis in all over-the-counter markets.

We believe that by moving derivative speculation solely to regulated futures exchanges and honoring the original intent of the inter-bank over-the-counter derivative markets, to meet end-user hedging needs, will

- Minimize unnecessary, costly regulations for regional commercial banks who have bona fide hedge needs for their customer base

- Eliminate dangerous systemic risk to the financial system for OTC derivative contracts that are not properly collateralized

- Eliminate excessive regulatory costs that burden the U.S. taxpayer, with no corresponding economic return to society.

The risk focus in the over-the-counter markets will be monitored solely by the CFTC, FDIC, Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve to ensure the few major and regional banks that make the large proprietary trades have sufficient capital. All trades by large energy companies and agricultural companies would require daily collateral postings. Energy companies have stated they need the flexibility of the OTC markets for the long-dated contracts, which is understood, but day-to-day mark to market collateral postings would be required. Although the cost of collateral will cut into these firms profit margins, that is not a bona fide rationale to push the risk and corresponding costs onto the U.S. taxpayer.

All commercial bank CEO's would sign reports on a daily basis on every over-the-counter trade that exceeds a certain pre-determined dollar amount and verify that the counterparty that necessitated the "customized contract" was for a bona fide hedge. Commercial bank CEO's would attest in writing that that have not created proprietary trades, outside of that necessary to "make a market" for an end user or for their own balance sheet, as "end user".

Failure to comply with the established regulations would result in criminal sanctions based on a combination of (1) a public panel established by an all-public group to be determined, (2) the Department of Justice and (3) a private right of action for any U.S. taxpayer to go to Federal courts for any out of pocket taxpayer costs caused by the infraction.

The judicial process for enforcement must be simple, clear and involve a public component, in conjunction with the Justice Department, SEC and a private right of action, due to the powerful role of lobbyists' money to influence regulatory bodies. Given the role of money in rulemaking, a new public panel must be added to represent taxpayers' interests that are independent of Congress, the Department of Justice, the SEC and the Executive Branch. This is comparable to the concept of the SEC Investor Advocate, mandated by Dodd Frank that the SEC and Congress have yet to fill.

Further, we urge an immediate, thorough analysis of the on-going use of credit default swaps in over-the-counter derivative markets. We attach a proposal sent to the House Financial Services Committee, submitted on February 23, 2012. The House Financial Services (HFS) Capital Markets Committee refuses to meet with The Derivative Project, as a non-partisan investor advocacy group on this proposal. This is not democracy, when Wall Street lobbyists control the Agenda and access to Congressional committees that have been elected to serve the public interest.

Congress, the SEC and the CFTC must justify and explain to every American taxpayer why when Wall Street requests a "cost-benefit" analysis, the SEC and Department of Labor will comply (such as the delay of implementation of Department of Labor ERISA fiduciary standard for IRA's) as proposed by the Department of Labor, but a Congressional Committee, HFS, refuses to perform a cost-benefit analysis of non-collateralized, speculative use of OTC derivatives for the American taxpayer. This is a very valid request considering the billions of dollars of taxpayer money used to bolster capital markets following ongoing inappropriate, speculative use of credit default swaps, not to mention a recent speculative credit default swap by a major U.S. Bank, which the size of the billion dollar loss is still yet to be established.

A common sense, straightforward solution that Congress and the public can understand is warranted given the toll that mismanagement of speculative risk and leverage in the over-the-counter derivative markets has taken on the American taxpayer. The social costs have been too great. Thank you very much for your consideration of these comments and proposed cost-benefit analysis.

Sincerely,

Susan Seltzer

President, The Derivative Project

TheDerivativeProject

Web: www.thederivativeproject.com

To: House Financial Services Committee Members

From: The Derivative Project

Subject:

Request for Cost Benefit Analysis: Transfer of Credit Derivative Hedging and Speculating from Over-the-Counter Derivative Markets to Regulated Futures Exchanges

The Derivative Project, a taxpayer advocacy group, requests that the House Financial Services Committee request that the Securities and Exchange Commission perform a cost-benefit analysis on potential taxpayer regulatory cost savings from the transfer of all speculative over-the-counter credit default swap contracts to regulated futures exchanges. The ability to hedge or speculative on a "credit event" would move to regulated exchanges, in newly created credit futures contracts.

- What are the proposed and current regulatory costs for U.S. taxpayers to fund the SEC, FINRA and the CFTC to monitor the systemic risks presented by over-the-counter credit default swaps?
- What are the proposed regulatory costs to oversee the proposed clearinghouses for over-the-counter credit default swaps contracts?
- What are the costs to oversee the Office of the Comptroller of the Currency's monitoring of over-the-counter credit default swaps?
- What are the cost-savings for U.S. taxpayers in the elimination of systemic risk, "contagion" when credit default swap contracts require mark to market collateral in every instance, overseen by a regulated exchange, in lieu of the current "honor" system by the counterparties?

  Credit default swaps differ substantially from other over-the-counter derivative contracts, such as foreign currency spot and forward contracts, in that the end user does not need to create a perfect hedge based on a forward date and amount. Further, 90 per cent of credit default swaps are for speculative purposes. End-user

exemptions in the over-the-counter foreign currency derivative markets have been established due to bona-fide hedging purposes, which is in the American economy's best interest overall. Conversely, excessive taxpayer regulatory costs to fund solely speculative over-the-counter derivative contracts may be contrary to public interest, particularly when there is not a compelling business need for customized over-the-counter contracts.

This request is made pursuant to the recent passing of SEC Regulatory Accountability Act, H.R. 2308, which requires the Securities and Exchange Commission, in accordance with President Barack Obama's executive order, to conduct robust cost-benefit analysis on each new rulemaking.

Further, this request is made pursuant to the House Financial Services Committee request that the SEC examine the cost and benefits of imposing a fiduciary standard on brokers.

There is a compelling public interest that the House Financial Services Committee ensures there is neutrality in the cost benefit analyses that are conducted by the SEC for both Wall Street, commercial banks and for the U.S. taxpayer to minimize regulatory costs.

We thank you in advance for sending this request at your earliest convenience to the Securities and Exchange Commission to ensure U.S. taxpayer regulatory costs are prudent and effective.

Sincerely,

Susan Seltzer
President, The Derivative Project

Cc:
The Honorable Mary Shapiro, Chair, Securities and Exchange Commission

The Honorable Gary Gensler, Chair, CFTC

The Honorable Senator Tim Johnson, Chair, Senate Banking