

Legislative Environment and Developments on Capitol Hill

Global Energy Management Institute Conference Re: “Dodd-Frank’s Impact on Energy Trading”

March 23, 2012



George D. Baker
Williams & Jensen, PLLC
701 8th Street NW
Washington, DC
202-659-8201
gdbaker@wms-jen.com

Focus in a nutshell:

What—if anything—are we expecting from Congress regarding Dodd-Frank, energy and energy trading in 2012 and 2013?

We will explore:

- **2012 Political Environment in Congress**
- **Legislative Proposals on Energy and Dodd-Frank related issues**

If you are fearing—or hoping—that Congress will enact a lot of energy and energy trading/Dodd-Frank legislation in 2012, relax yourself!

The amount of enacted legislation has declined significantly of late:

- Public Laws enacted in the 112th Congress (2011/2012)

As of March 1, 2012, Congress has passed and the President has signed **97** bills into law, including these 42:

- **3** naming court houses;
- **12** naming post offices;
- **3** designating Smithsonian regents;
- **14** temporary extensions of programs (including FAA and highways);
- **10** appropriations bills (including 5 continuing resolutions).

By comparison:

- 110th Congress: As of March 1, 2008 President Bush signed **192** bills into law.
- 111th Congress: As of March 1, 2010 President Obama signed **143** bills into law.

Right now, it is extremely difficult to enact ANY legislation:

Low expectations for Congress to take action in 2012 on anything significant, including energy legislation or Dodd-Frank legislation that might either hurt or help energy trading.

General perception of “nothing controversial moves before the 2012 election” and virtually everything is “controversial”.

Very easy to block any legislation from moving:

Even the highway bill is a huge lift!

Gridlock has incentives as both a shield and a sword:

- **If you oppose a proposal, the current gridlocked situation provides significant opportunity to block it from moving to enactment in Congress.**
- **Both parties use gridlock to their strategic political advantage to “blame” the other party when it suits their purpose: lots of bill introduced knowing they are not going anywhere, but create a political issue.**

Is consensus possible? Yes but it is very difficult

Consensus is elusive even on the most fundamental things—like funding the federal government—or even when there is an emergency:

Witness the failure of the budget negotiation “Super Committee” in late 2011 (debt ceiling crisis)

Witness no congressional budget adopted for FY-11, FY-12 or now FY-13 (last budget resolution was for FY-10)

Witness breakdown in annual appropriations process and now persistent resort to funding federal government by series of Continuing Resolutions rather than enactment of 13 appropriations bills in “normal order”.

Is there any wonder why Americans view Congress as being less characterized by this film



Than this film:



Why is Congress so dysfunctional?

Dominated by 2012 Partisan Election-Year Politics which produces incentives for gridlock:

And the election never ends!

Both parties succumb to the “electoral imperative” and use the legislative process as a vehicle to make political “points” for electoral purposes that advantage themselves and disadvantage the other party’s agenda.

As a result, partisanship in Congress is very high and intensifying as 2012 develops

Recall that House Speaker Boehner and Senate Majority Leader McConnell established their top priority for the 112th Congress as making Barack Obama a One-Term President.



And Obama, Senate Majority Leader Reid and House Minority Leader Pelosi demonize “the Republicans in Congress” as the roadblock to common-sense bi-partisan policies.



Will November 2012 Elections Change the Situation?

- Not Likely!

Probable that Republicans will retain control over the House:

Currently **242** Republicans vs. **193** Democrats

Query: size of Republican majority in 2013.

Same? Larger? Smaller?

But Democrats remain optimistic about their “Red to Blue” strategy to capture the **25** seats needed to re-take the House majority

Would be another “sea change” election to sweep Democrats back into control of House

Biggest question marks:

Presidential Election?

Senate control?

A Third of Senate Seats Up for Election: Right now it's **53** Democrats vs. **47** Republicans

- At play this November: **23** incumbent Democratic-held seats
vs
10 incumbent Republican-held seats

- Key Questions:

- Will Democrats retain Senate majority?

Much may depend on momentum and outcome of Presidential race

- Will Republicans pick up the **4** seats to take control of Senate (or more)?

Recall that the majority party—even with less than **60** votes—still determines who chairs the Senate Committees and controls the Senate floor agenda, and that is worth fighting over even if the majority is stymied by filibusters by the minority.

*“I’d rather be in the minority with **49** votes than in the majority with **51!**”*

--Former Senate Majority Leader Howard Baker

- Will either party secure the **60** seat majority to prevent the other party from filibustering?

Not Likely.

If Obama is re-elected:

Continued Democratic control of Senate gives Obama leverage to use against presumed Republican-controlled House.

If Republicans take control of Senate, then Obama is faced with negotiating with an entire Republican-controlled Congress.

A Republican take-over of the Senate though does **NOT** mean Republicans have unbridled power to move their legislative preferences. If Republicans do not have 60 votes, the Democratic Senate minority and Obama's ability to veto still gives the Democrats very considerable leverage.

Bottom line: If Obama is re-elected, we likely will still be looking at gridlock after the 2012 election whether or not the Republicans take over the Senate.

If a Republican is elected president:

- And Republicans take control of both the House and Senate, significant change in the current legislative logjam is *theoretically* possible:
 - Implications for Dodd-Frank
 - Energy legislation
 - Tax legislation (expiring Bush Tax Cut package etc.)
- But if Democrats retain control of Senate, or even retain more than 40 seats, the two parties each will continue to exert considerable leverage in their ability to block one another's legislative initiatives and gridlock can continue.

**So what about energy
in this gridlocked
political environment in
Washington?**

WHY IS THIS MAN SMILING?



AND ANOTHER
THING...I'VE CHANGED
MY MIND ABOUT
DRILLING



Derek Cogale
apnsc.com

SOMEHOW WE HAVE TO FIGURE OUT HOW TO BOOST THE PRICE OF GASOLINE TO THE LEVELS IN EUROPE.



Both parties taking this issue seriously, looking “concerned” and wondering what they can do for their own advantage realizing, along with the public, that there is little that can be done quickly or in the short run to favorably impact the price of gasoline at the pump:

Rep. Whitfield: Create interagency council to study price of gasoline, including impact of regulations on gasoline price (Tier 3 sulfur reductions; GHG limits on refiners; renewable fuel standard; ozone limits etc.); delays enviro regs pending study.

Senator Sanders: amendment to JOBS bill to mandate that CFTC exercise all its existing authority within 14 days “to curb immediately” excessive speculation, price distortion, sudden or unreasonable fluctuations or unwarranted changes in prices on any market within CFTC’s jurisdiction.

While there is not much moving toward enactment, there is plenty of “Energy” Legislation being debated on a partisan basis on the Hill:

Price of Gasoline

Strategic Petroleum Reserve

Solyndra

DOE Weatherization Program

Clean Energy Standards for Utilities

Clean Air regulations (UMACT, CSAPR), coal ash regulation, 316(b), fracking

Onshore federal lands/OCS leasing

Keystone X-L Pipeline

Oil and LNG Exports Ban

DOE Renewable Energy Loan
Program Investigations

Renewable Energy Tax Credits

Endangered Species Act reform

Oil and Gas taxation

But all these too are controversial and are tied up in the gridlock because they are being used to score political points, advance electoral positions with voters and disadvantage “the other party” in the coming elections rather than reach consensus in legislation.

For example: During the Senate’s floor action on the Highway bill last week, several energy amendments were allowed to be brought up under the condition that they could be adopted only if they received 60 votes—note the magic number 60— and all failed even though some received more than 50 votes:

Vitter OCS amendment to deem the Interior Department’s draft OCS leasing plan to be approved: Defeated 47 to 53

Wyden Keystone XL Pipeline amendment: would approve the permit but prohibit the export of any oil transported through the pipeline and would require “Buy America” provision for construction: Defeated 33 to 65.

Hoeven Keystone XL Pipeline amendment: would grant the permit but make it subject to a route through Nebraska approved by Nebraska: Defeated 56 to 42

Stabenow amendment to extend expiring and expired energy tax credits: provide one-year extensions of federal tax credits for energy-efficient existing homes, electric cars, alternative fuel refueling stations, cellulosic biofuel production, algae feedstock, biodiesel and renewable diesel, production credits, energy-efficient new home sales, energy-efficient appliances, wind farms, advanced energy projects, marginal well depletion, alternative fuels excise tax credits, and grants for specified energy properties (no offset) ; Defeated 49 to 49

DeMint amendment to repeal energy tax credits for all sources of energy (alcohol fuels, biodiesel, and alternative fuel mixes; plug-in electric vehicles; qualified fuel cell vehicles; alternative fuel vehicle refueling stations; enhanced oil recovery; electricity produced from renewables; oil and gas production from marginal wells; electricity produced from advanced nuclear power facilities; carbon dioxide sequestration; advanced coal projects; gasification projects; American Recovery and Reinvestment Act energy grants; and use the proceeds to pay for a reduction in the corporate income tax rate. Defeated 27-72.

Menendez/Burr amendment to approve the Boone Pickens “Natural Gas Act” to encourage use of natural gas for transportation fuel by boosting domestic production of vehicles that run on clean natural gas by extending tax credits for natural gas vehicles and building refueling infrastructure, and increasing the federal share of transit projects for natural gas buses; all to be fully paid for by a temporary user fee on natural gas used as a vehicle fuel. Defeated 51-47.

Roberts amendment: approving the Keystone XL pipeline; expanding offshore energy development; providing for increased oil shale and tar sands exploration; and providing one-year extensions of federal tax credits for energy-efficient existing homes, alternative fuel refueling stations, biodiesel and renewable diesel, energy-efficient appliances, sales or dispositions of electric restructuring policies, marginal well depletion, and alternative fuels excise tax credits, as well as a host of non-energy tax extenders, to be offset by energy proceeds, federal pension reform, and lower discretionary spending limits. Defeated 41 to 57.

Energy Taxes:

Obama proposes to eliminate “subsidies” for oil and gas Industry and re-target to lower deficit and support renewables.

Major changes affecting oil and gas, other energy industry players and energy trading not likely until 2013 when tax reform may be taken up by Congress.

But, be alert to the 2012 post-election lame duck session when taxes could be considered as part of any deal to avoid budget sequestration in January 2013, and provide “pay-fors” to fund any deal to extend the expiring Bush Tax Cuts.

With the legislative approach gridlocked, the focus of Hill “action” on energy largely shifts to influencing what the Federal agencies are doing:

CFTC, SEC, Fed

EPA, DOE, FERC, Interior

But what are we seeing discussed and proposed in Congress that is directly relevant to Dodd-Frank and energy trading?

Dodd-Frank amendments

CFTC Appropriations

Transaction Taxes and Fees

MF Global

STOCK Act

Dodd-Frank amendments

Dodd-Frank Repeal

Dodd Frank effective date

Swap Execution Facility

Protections for End-Users

Inter-Affiliate Swaps

Extraterritoriality

Position Limits

Movement of these DFA amendments is impeded by:

- **The general legislative gridlock**
- **Democratic unwillingness to revisit Dodd-Frank which is viewed as a significant accomplishment of the Obama Administration. Expect any Dodd-Frank amendments that pass the Republican controlled House to be stonewalled in the Democratic controlled Senate.**
- **The agencies still have not produced final rules on many issues of concern to the Hill and their constituents, so legislation is viewed as premature. But as rules are finalized they become more “ripe” for Congressional amendment later in 2012 or in 2013.**

Consequently, Congress has resorted to:

- Introducing “messaging” legislation to identify issues, and to demonstrate concern for constituents’ complaints and preferred solutions for the agencies to adopt in their regulations to provide relief**
- Engaging in extended, aggressive committee oversight of the agencies’ rulemaking processes and funding**
- Peppering the agencies with letters from Members of Congress raising concerns and urging specific regulatory responses.**

Dodd–Frank Repeal in 2012: *Fuggetaboutit!*

All Republican Presidential candidates vow to repeal Dodd-Frank.

Repeal bills have been introduced since early 2011 in both the House (HR 87, Rep. Bachman) and the Senate (S. 746, Sen. Shelby and S. 712, Sen. DeMint)



How about Repeal of Dodd-Frank in 2013?

If Republicans control White House and both the House and Senate, Democrats could still block repeal in Senate.

Political risk to GOP if economic disaster strikes again and DFA reforms might have helped.

**Plus, GOP supported various aspects of what became DFA:
Increased transparency, reporting.**

Republicans might focus more on significant revision to Dodd-Frank, rather than repeal, keeping elements that they view as good reforms and eliminating what they view as excessive regulation (Volcker Rule; prescriptive derivative trading protocols; Consumer Financial Protection Bureau etc.).

**If Obama wins in November '12,
Dodd-Frank is ensconced.**

- Look for amendments at most,
not repeal.**
- And any amendments may still
be complicated by political
gridlock in 2013.**

Extend Dodd-Frank Effective Date:

- Rep. Lucas, Chairman of House Agriculture Committee, introduced HR 1573, to postpone the effective date of Title VII of Dodd-Frank to September 30, 2012.

Senator Crapo considering delaying July '12 Volcker rule implementation date.

- Not likely in 2012 given the political grid lock and the already successive delays ordered by the CFTC and SEC and the agencies' protracted roll-out and phasing in of regulations over the next year. Final Volcker compliance date in 2014.
- Congress will likely wait to see what the agencies actually finalized before stepping in with legislation to alter the implementation dates.

Swap Execution Facility (SEF): Don't over-regulate trading protocols

HR 2586, "Swap Execution Facility Clarification Act" by Rep. Garrett, passed by House Financial Services and House Agriculture Committees

HR 2586 would prohibit the CFTC, in interpreting or defining a SEF from requiring it to:

1. have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality,
2. display or delay bids or offers for any period of time,
3. limit the means of interstate commerce used by market participants to enter into and execute swap transactions on the trading system or platform, or
4. require bids or offers on one trading system or platform operated by the SEF to interact with bids or offers on another trading system or platform operated by that facility.

Who is a “swap dealer”?

Several exposures for energy interests

- A. End users of swaps, especially energy end-users, are pushing CFTC and Congress hard to insure that they are not considered “swap dealers” in the regulatory definitions and thereby subject to the panoply of swap dealer obligations and restrictions involving capital, reporting, business standards etc. that are aimed at the major swap dealer banks.

CFTC’s Chairman Gensler has indicated the final swap dealer definition will exclude commercial end-users and Farm Credit institutions, but will **NOT EXCLUDE MARKET MAKERS:**

Most exposed: Several large energy companies make markets in swaps and are “primary members” of ISDA, a category that expressly excludes any entity that “participates in derivatives transactions solely for the purpose of risk hedging or asset or liability management.”

If the CFTC final definition of swap dealer includes commercial end-users, expect Congress to try to address the issue.

HR 3527, “The Protecting Main Street End-Users From Excessive Regulation Act” by Rep. Hultgren (R-Illinois)

Adopted by House Ag Committee in January 2012

HR 3527 would:

- **revise the current exception to the definition of "swap dealer" to eliminate consideration of any transaction entered into for a person's own account for the purpose of hedging or mitigating commercial risk;**
- **direct the CFTC to exempt from designation as a swap dealer an entity that enters into swap dealing transactions with or on behalf of its customers if the aggregate gross notional amount of the outstanding swap dealing transactions entered into over the course of the preceding calendar year does not exceed \$3 billion (adjusted for inflation): protects small/medium banks**

B. Will Regional Transmission Organizations be exempted from CFTC's swap regime and/or "swap dealer" definition?

Recall the Amaranth jurisdictional dispute between FERC and CFTC.

- **Dodd-Frank Section 720 directed CFTC and FERC to negotiate an MOU to resolve jurisdictional disputes between the two agencies (such as whether RTOs were subject to CFTC's swaps regime).**

No MOU negotiated thus far.

CFTC wants to retain jurisdiction over RTOs and other energy trading that might look like swaps trading but provide exemptions.

FERC wants CFTC to yield to FERC's jurisdiction over wholesale electricity (transmission/RTOs etc.) and interstate gas markets.

Very messy issue in Congress due to competing jurisdictions of Committees that oversee the CFTC and FERC.

- **California utilities have a particular problem due to state regulatory obligations regarding their carbon allowances, renewable energy RECs, resource adequacy certificates, and tolling agreements, which they fear CFTC could deem to be swaps and the utilities as swap dealers.**

Are Inter-Affiliate Swaps “Swaps”?

HR 2779 introduced by Rep. Stivers (R-OH)

Approved by House Ag Committee in February 2012, HR 2779 would:

- Exclude from the meaning of the terms “swap” and “security-based swap,” for purposes of clearing and execution requirements, capital and margin requirements, and for defining a swap dealer or a major swap participant, any agreement, contract, or transaction that: (1) would otherwise be included as a “swap” or “security-based swap”; and (2) is entered into by parties that report information or prepare financial statements on a consolidated basis (controlling, controlled by, or under common control with its counterparty), or for which an affiliated company reports information or prepares financial statements on a consolidated basis for both parties.
- But still require that such exempted agreements, contracts, or transactions be reported to an appropriate data repository.
- Prohibit a federal or state regulator of an insurance fund or guaranty fund from subjecting security-based swap transactions between affiliated companies to certain: (1) clearing and execution requirements, (2) margin and capital requirements, or (3) reporting requirements (other than those prescribed under this Act).

Commercial End User Exemption concerns:

A. Dodd-Frank exempts commercial end-users from the otherwise applicable mandatory swap exchange trading and clearing requirement.

End users want a broad exemption that is easy to comply with and covers their swaps activity for a significant period such as a year. Thus far, CFTC prefers to take a transaction-by-transaction approach.

B. In exempting commercial end-users from mandatory exchange trading and clearing, Dodd-Frank exempts such end-users from being obligated to post collateral/pay margin

CFTC was initially less clear but now says its rules will not require end-users to post collateral/pay margin, and confusion was increased by the swaps rules proposed by banking prudential regulators that suggest banks may be required to do so.

HR 2682 “The Business Risk Mitigation and Price Stabilization Act” by Rep. Grimm (R-NY) would make sure that end-users are exempt from margin requirement. Approved by both House Ag and House Financial Services Committees.

See also, S. 947 (Sen. Johanns (R-NE)) and S. 1650 (Sen. Crapo. (R-ID))

Extraterritorial reach of Dodd-Frank:

A huge issue with enormous international implications:

- 1. the global competitiveness of U.S. firms could be impacted;**
- 2. non-U.S. firms may determine that it is too costly to serve U.S. customers and markets;**
- 3. the overall health and liquidity of global markets may suffer;**
- 4. dual and contradictory regulations will add additional costs or make it impossible to comply with all jurisdictions' rules;**
- 5. additional costs will be passed on to end users and the real economy; and**
- 6. the sovereignty of foreign countries may be inappropriately infringed upon which may, in turn, invite regulatory retaliation.**

Banks and swap dealers raised concerns with domestic and international regulators about impact of excessive extraterritorial application of Dodd-Frank

CFTC rulemaking/guidance on extraterritoriality will be closely watched by Congress. Potential for bi-partisan response here.

HR 3283 “The Swap Jurisdiction Certainty Act” introduced by Rep. Himes would constrain reach of Dodd-Frank.

Position Limits

Dodd-Frank authorized CFTC to establish speculative position limits for physical commodity derivatives that would aggregate positions in equivalent contracts across futures and swaps markets in the same underlying commodity.

CFTC issued its final position limits rule in November 2011 establishing rules for 28 specific physical commodities

CFTC position limits do not apply to bona fide commercial hedging

End-users have some concerns with aggregation and concept of “bona fide hedging”

There are fans of aggressive position limits in Congress who support CFTC's strong and quick implementation of those position limits:

- **H.R. 2328, “End Excessive Oil Speculation Now Act of 2011” by Rep. Hinchey (D-NY) would direct the CFTC to:**
 - 1. establish speculative position limits in any registered trading entity on or through which crude oil, gasoline, diesel fuel, jet fuel, or heating oil futures or swaps are traded that are equal to the position accountability levels or position limits established by NYMEX;**
 - 2. establish margin requirements of 12% for speculative swaps and futures trading in crude oil, gasoline, diesel fuel, jet fuel, and heating oil; and**
 - 3. require each bank holding company, investment bank, hedge fund, or swaps dealer trading energy futures or swaps for its own benefit, or on behalf of, or as counterparty to, an index fund, exchange traded fund, or other noncommercial participant, to register with the CFTC as a noncommercial participant and be subject to position limits and margin requirements under this Act.**

Senator Bernie Sanders (I-VT) introduced a similar bill, S. 1200 in the Senate.

H.R. 3006 “Anti-Excessive Speculation Act of 2011”, introduced by Representative Peter Welch (D-VT) would seek to revise the registration requirements for foreign boards of trade and establish individual position limits on energy contracts (referencing the price of crude oil, gasoline, diesel fuel, jet fuel, heating oil, or natural gas) that are applicable to long or short positions. The bill:

defines an “excessive speculative position” as a position that affects more than 5% of: (1) the estimated deliverable supply of the same commodity in the spot month, and (2) the open interest in a contract in a single month or all months combined.

prohibits any person from holding or controlling an excessive speculative position, long or short, in an energy contract in any single market and aggregated across all markets in the spot month, a single month, or all-months combined.

directs the CFTC to establish aggregate speculative position limits for long energy contracts held by speculators as a class of traders in any single market and in all markets. It also excludes bona fide energy hedging from the computation of positions held or controlled by a person.

Senator Bill Nelson (D-FL) introduced a similar bill, S.1598.

But CFTC's Position Limits rule has its critics:

December 2011, ISDA and Securities Industry & Financial Management Association (SIFMA) filed suit challenging CFTC's position limits rule:

Primary arguments: CFTC failed to

- do adequate cost/benefit analysis;
- determine whether position limits were even necessary;
- present a reasoned analysis or consider all evidence in setting position limits;
- conducted a flawed rulemaking process that prevented commenter's from meaningfully participating.

Builds on recent court decision striking down SEC's rule on proxy access rule for inadequacy of cost-benefit analysis

CFTC's defense: CFTC met the requirement of the Commodity Exchange Act Section 15(a)

Cost Benefit Analysis of Dodd-Frank rules

CFTC does not comply with the generally applicable cost-benefit requirements of the Administrative Procedures Act, but rather complies with Section 15(a) of the Commodity Exchange Act which requires consideration of the costs and benefits of:

- 1. Protection of market participants and the public;**
- 2. The efficiency, competitiveness, and financial integrity of futures markets;**
- 3. Price discovery;**
- 4. Sound risk management practices; and**
- 5. Other public interest considerations**

ISDA/SIFMA case potentially has significant implications:

Decision could come any day

If plaintiffs win on their cost benefit claim, the defect would:

- **return the position limits rule to CFTC for further consideration and time delay.**
- **potentially infect any number of other CFTC Dodd-Frank regulations—some finalized and others still in proposed form, since CFTC has been relying on CEA Section 15(a) and its interpretation of what cost-benefit means for CFTC’s regulations.**
- **unleash a strong response from Congressional supporters of tight position limits as a means of mitigating excessive speculation in commodity/energy markets. The ball could be thrown back into Congress’s court for possible legislative action to address gas prices.**

If CFTC prevails in the case:

Plaintiffs may well appeal and they may win down the road

But CFTC would be expected to proceed to enforce its position limits rule

CFTC will also feel affirmed with regard to its reliance on CEA Section 15(a) and its cost/benefit analysis used for the raft of Dodd-Frank rules

Members of Congress who oppose what CFTC has done on position limits could view the court decision as a signal that Congress needs to step in, resulting in efforts to move legislation requiring more and/or different cost-benefit analysis by CFTC for Dodd-Frank rules.

- **SEC: H.R. 2308, the “SEC Regulatory Accountability Act” introduced by Rep. Garrett (R-NJ) would amend the Securities Exchange Act of 1934 to require the SEC, before promulgating a regulation or issuing any order, to: (1) identify the nature and significance of the problem that the proposed regulation is designed to address in order to assess whether any new regulation is warranted; (2) use the Office of the Chief Economist to assess the costs and benefits of the intended regulation and adopt it only on a determination that its benefits justify the costs; and (3) ensure that any regulation is accessible, consistent, written in plain language, and easy to understand. On February 16, 2012, the House Financial Services Committee favorably reported this bill as amended in a voice vote.**

- **CFTC: HR 1840, introduced by Rep. Conaway (R-TX) would require the CFTC's Chief Economist to assess the costs and benefits of the intended regulation and propose or adopt a regulation only on a reasoned determination that the benefits of the intended regulation justify the costs of the intended regulation:**

CONSIDERATIONS- In making a reasoned determination of the costs and the benefits, the Commission shall evaluate—

- A. protection of market participants and the public;**
- B. efficiency, competitiveness, and financial integrity of futures and swaps markets;**
- C. impact on market liquidity in the futures and swaps markets;**
- D. price discovery;**
- E. sound risk management practices;**
- F. available alternatives to direct regulation;**
- G. the degree and nature of risks posed by activities within scope of its jurisdiction;**
- H. whether the regulation is tailored to impose the least burden on society, including market participants, individuals, businesses of differing sizes, and other entities, taking into account, to the extent practicable, the cumulative costs of regulations;**

- I. whether the regulation is inconsistent, incompatible, or duplicative of other Federal regulations;
- J. whether alternative regulatory approaches maximize net benefits (including potential economic, environmental, and other benefits, distributive impacts, and equity); and
- K. other public interest considerations.

- **Financial Regulators: S. 1615, the “Financial Regulatory Responsibility Act of 2011,”** introduced by Senator Shelby (R-AL) would hold financial regulators accountable for rigorous, consistent economic analysis on every new rule they propose.

Requires clear justification for the rules, and determination of the economic impacts of proposed rulemakings, including their effects on growth and net job creation.

Improves the transparency and accountability of the regulatory process and reduces the burdens of existing regulations.

Mandates that if a regulation’s costs outweigh its benefits, regulators are barred from promulgating the rule.

- **Rulemaking Process Reform: S.1606, “The Regulatory Accountability Act”**, introduced by Senator Portman would seek to generally reform the regulatory process by requiring agencies to undertake a more rigorous cost-benefit analysis.

CFTC Appropriations

Dodd-Frank substantially expanded (perhaps doubled) CFTC's work load and mission. Obama Administration has requested significant increase in CFTC's Budget for more personnel, technical resources etc. Republicans in Congress have kept CFTC funding constrained:

<u>F/Y</u>	<u>CFTC Request</u>	<u>Administration's Budget</u>	<u>Actual Congressional Appropriation</u>
2010	\$191 million	\$160.6 million	\$168.8 million
2011	\$216.2	\$261	\$202.3
2012	\$349	\$308	\$205.3
2013	\$317.4	\$308	\$\$\$??????

- **Republicans' constraint on CFTC funding creates leverage for them on Dodd-Frank issues**
- **CFTC openly worries that while it has the budget/personnel to finalize the Dodd-Frank rules, the agency will lack the resources to properly administer and enforce the new rule while still meeting its non-Dodd-Frank obligations**
- **CFTC argues that an under-funded CFTC: impacts the kind of rules it will produce, requiring the use of more prescriptive rules rather than principle-based rules; requires greater reliance on outsourcing of Dodd-Frank regulation to the National Futures Association (futures industry SRO); and mitigates the thoroughness, responsiveness and effectiveness of its futures and swaps regulation.**

Implications for industry:

- Adequacy and efficiency of CFTC regulation of futures and swaps markets
- Scarcity of federal funding in budget deficit era invites discussion of alternatives such as more regulation by NFA (which can already charge fees) or imposition of a CFTC transaction tax/fee on market participants.

Imposition of derivatives Transaction Fee/Tax

Historically, the Obama Treasury Department has supported imposition of an unspecified transaction fee to fund CFTC operations. Congress has consistently rejected such proposals.

Supporters argue:

- Parallels SEC Section 31 transaction fee that funds SEC
- Budget constraints make funding CFTC's expanded mission post-Dodd-Frank from annual appropriations difficult
- Germans and French urging imposition of transaction tax



HR 2003 “The Taxing Speculators Out of the Oil Market Act” introduced by Rep. DeFazio (D-OR).

- Stated objective: “Target Wall Street speculators that are responsible for unnecessarily inflating the price of gas up to 80 cents a gallon”

Would impose a 0.01% (one basis point) tax on all crude oil derivatives (futures, options and swaps).

- Cites Exxon and Goldman-Sachs for evidence of a “speculative premium” of \$21-\$38 per barrel of oil

Exempts all “legitimate hedgers” (commercial end users) from the tax, but to prevent evasion by moving trading overseas, all US citizens must pay the tax regardless of where they trade and foreign citizens must pay the tax if they trade on US-based exchanges or are dealing with a US citizen in an OTC trade.

All revenues raised by the tax would go to offset the cost of CFTC operations.

“Wall Street Trading and Speculators Tax Act” (S. 1787), introduced by Senator Tom Harkin (D-IA) would impose a **.03% excise tax on the purchase of a security by U.S. persons on exchanges in the U.S.**

Defines "security" to include:

- 1. stocks, partnership interests, notes, bonds, debentures, or other evidences of indebtedness; and**
- 2. interests in a derivative financial instrument (i.e., any option, forward contract, futures contract, notional principal contract, or any similar financial instrument).**

Exempts from such tax: (1) initial issues of securities; (2) any note, bond, debenture, or other evidence of indebtedness which has a fixed maturity of not more than 100 days; and (3) securities traded pursuant to certain lending arrangements.

Other derivatives tax issues getting attention in 2012:

Elimination of Section 1256 “60/40” tax treatment for futures?

- “60/40” treatment under Section 1256 of IRC:

Gains and losses on futures, non-equity options, FX, dealer options and security futures contracts are taxed as 60% capital gain/capital loss and 40% short term gain/loss

- Section 1601 of Dodd-Frank mandated no “60/40” tax treatment for swaps (IRS, FX, basis, IR caps, IR floors, commodity, equity, equity index CDS and “similar agreements”) which could implicate certain types of contracts that currently receive “60/40” treatment

IRS rulemaking on Dodd-Frank provision has language that could adversely affect futures that currently qualify for 60/40 treatment due to exclusion of still undefined **“notional principal contracts” and contracts that are “similar agreements”** to swaps.

S. 2033 “The Closing the Derivatives Blended Rate Loophole Act” by Senator Levin (D-MI) :

Would treat all gain or loss with respect to a section 1256 contract (i.e., any regulated futures contract, foreign currency contract, non-equity option, dealer equity option, and dealer securities future contract) as short-term capital gain or loss.

ABA Tax Section advocates repeal of 60/40, citing evolution of equivalent products that should all be taxed similarly.

And of course....MF Global



Several Committees held numerous hearings and will likely hold more:

Congress is waiting for investigations to determine what happened, why and where is the missing customer funds. House Oversight & Investigations Subcommittee considering subpoenas of MF Global execs

Strong sympathy for customers who await return of their money

Congress pressuring regulators to maximize speed and size of recovery by customers

MF Global-related legislative issues:

Segregation and enhanced customer protections

Possible insurance regime

Effectiveness of CFTC regulation/oversight in face of fraudulent activity

Bankruptcy changes

STOCK Act: “Insider Trading” (of sorts!)

On February 2, 2012 the Senate approved the “Stop Trading on Congressional Knowledge (STOCK) Act of 2012” (S. 2038) as amended in a **96-to-3** roll call vote. Introduced by Senator Joe Lieberman (ID-CT), the legislation “would prohibit Members of Congress and employees of Congress from using nonpublic information derived from their official positions for personal benefit.” Several of the amendments approved included:

1. **Application to Executive Branch and Independent Agencies:** would extend the STOCK Act reporting requirements to apply to executive branch and independent agency employees that are subject to the disclosure provisions under the Ethics in Government Act of 1978.
2. **Political Intelligence Disclosure:** would require covered individuals and organizations to register and file quarterly reports of “political intelligence activities” using the same regime and requirements established for lobbyists under the Lobbying Disclosure Act.

On February 9, 2012, the House in a **417-to-2** vote approved a substitute amendment to the “Stop Trading on Congressional Knowledge (STOCK) Act of 2012” (S. 2038).

Note: the “political intelligence” provision in the Senate-passed bill was not included in the House version because Republicans viewed it to be “outside the scope of the bill”, which is to protect the integrity of Congress. Instead, there is a provision in the House bill that calls for a study of the “political intelligence” issue to be conducted by the Government Accountability Office in consultation with the Congressional Research Service.

Senate may take up the House bill very soon.

Lame Duck Session in 2012: The Big Showdown?

The post-election “lame duck” session this year—mid-November through Possibly Christmas Eve—is being viewed as the dumping place for all the work that will not otherwise get done this year:

Extension of expiring (12-31-12) Bush Tax Cut package, including dividend and capital gains rates, R&D

Continuing resolution for funding the balance of FY-13

Budget Cut package to avoid automatic \$1.3 Trillion sequestration for defense and non-defense spending in January 2013: extension of unemployment benefits and payroll tax cuts

Debt Ceiling extension

Farm Bill reauthorization/Highway reauthorization?

Expectations that everything will get done are unreasonable, and agreements will be complicated by 2012 election results and pre-2014 election political calculations by both Republicans and Democrats in Congress and White House.

These enormous end-of-session legislative challenges are typically handled in large packages negotiated by the Congressional leadership in concert with White House.

This year Obama will be either a lame duck President or a President looking at another 4 years in office and an ongoing legacy to think about.

Such large bills do not follow “normal order” and may not be subject to floor amendment:

The handful of Congressional leadership “in the room” exercises control

Any number of items can be jammed in as part of the deal-making in negotiations to get to a package that can pass

“Ripe” Dodd-Frank amendments for sympathetic constituencies could be included in an “omnibus” bill to address perceived defects in any final or proposed CFTC/SEC rules

No one in Washington will be booking vacations during the lame duck session:

Regardless of what happens—or does not happen--on Dodd-Frank, the energy agenda or taxes between now and the November elections, be prepared for action after the election in the end of year lame duck session.

You will need to be alert for opportunities to get valuable things done and to take defensive action against things that will be harmful to your interests. But you need to start protecting your interests NOW!

Other than that, enjoy your Thanksgiving and Christmas!!