



April 30, 2010

United States Senate
Washington, DC 20510

Dear Senator:

Americans for Financial Reform is a coalition of more than 250 consumer, employee, investor, community, labor and civil rights groups. Consumer Federation of America is a non-profit association of more than 280 groups that, since 1968, has sought to advance the consumer interest through advocacy and education. Our coalitions and the undersigned organizations urge you to retain important protections in the Restoring American Financial Stability Act for pension funds and state and local governments that purchase derivatives.

Faced with the possibility of derivatives regulation that would rein in their abusive practices, the major over-the-counter derivatives dealers are pulling out the stops to weaken the bill. Their latest target is a provision in Section 731 of the Restoring American Financial Stability Act that would impose a fiduciary duty on swaps dealers doing business with cities, states, government agencies, pension plans and endowments. This provision is essential to combating the kind of abuses that have left government entities and non-profits across the country struggling under staggering derivatives-related debts, and to giving essential protections to pension plans. It must not be removed from the bill.

Just as they got end users to do their dirty work to try to weaken clearing and exchange trading requirements, the OTC derivatives dealers have convinced some pension funds and municipalities to lobby against the fiduciary duty provision. They have apparently done so by telling them that a fiduciary duty would preclude them from both “representing” the pension funds or government entities and taking the other side of a derivatives transaction. Contrary to the scare tactics being used by the industry, nothing about the legislation would require dealers to “represent” the pension funds and others on the other side of the transaction. In reality, a fiduciary duty imposes two basic requirements: it requires the dealer to have a reasonable basis for believing the contract is in the best interests of the customer, and it requires the dealer to disclose all material information, including information about conflicts of interest that could bias their recommendations.

The real issue for dealers is much cruder, as SIFMA CEO Tim Ryan made clear in a statement to *Bloomberg*, “Dealers that would be subject to such a requirement would most likely stop doing business with those entities.” In other words, if derivatives dealers have to act in the best interests of these clients, they would no longer be interested in the business. Given the mind boggling profits they have made from this business over the years, this is hardly a credible threat.

Imposing a fiduciary duty would undoubtedly require a dramatic and much needed change in industry business practices. A recent account in *The New York Times*, “The Swaps that Swallowed Your Town,” describes how municipalities, school districts, sewer systems and other tax-exempt entities have become “ensnared in the derivatives mess.” According to that article, although the swaps at the source of those problems were sold as a way for tax-exempt debt issuers to reduce their financing costs, “the promised benefits of these swaps have mutated into enormous, and sometimes smothering, expenses,” in large part because of features built into the swaps that benefit dealers at taxpayer expense.

The poster child in this case is Jefferson County, Alabama. An SEC settlement of pay-to-play charges last fall imposed fine and fees on J.P. Morgan totaling \$75 million, and forced it to cancel a \$647 million fee it had proposed to charge the county. Nonetheless, the business still proved enormously profitable for the firm, though it left the county struggling under billions of dollars in debt. Because of features of the contract that benefited J.P. Morgan at taxpayers’ expense, the county was forced to pay off \$800 million of debt in four years instead of 40, and annual payments on its debt jumped from \$53 million to \$636 million in a single year.

Pension plans are set up to allow employers who sponsor them to contribute steadily over time. They offer retirees and their spouses’ retirement income over their lifetimes. They can hold tens of billions in plan assets and owe much, much more in terms of promised benefits and liabilities. These plans invest in derivatives contracts and other alternative investments. Much has been written about the use of these investments to hedge long-term liabilities, to seek significant investment gains, or as part of accounting techniques.

We believe that any opposition to the fiduciary obligation for sales of derivatives to pension funds originates from pension funds controlled by corporate interests, where there is a history of subordinating the welfare of plan participants to those of the corporate sponsor. If these corporate interests are successful in eliminating the fiduciary duty provisions, their pensions may become conduits for risky activities that benefit the plan sponsors. And if what Warren Buffett called the “financial weapons of mass destruction” are detonated it won’t just be the plan sponsors who suffer, it will be the workers.

In light of the record of abuse of municipalities by derivatives dealers, and the overwhelming evidence that most pensions and government entities lack the financial sophistication to protect their own interests in these transactions, the case for imposing a fiduciary duty on swaps dealers in their dealings with these entities is overwhelming. Taxpayers are tired of footing the bill to line Wall Street’s pockets. We urge you to ignore the scare tactics being used by the Wall Street firms and retain the fiduciary duty for swaps dealers in the financial regulatory reform bill.

Sincerely,

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AFL-CIO
Consumer Union
Laborers' International Union of North America
Public Citizen
National People's Action
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