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VIA ELECTRONIC MAIL

Ms. Alicia L. Lewis
MRAC Designated Federal Officer and
Special Counsel to Commissioner Rostin Behnam
Commodities Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: [MRAC Nomination and Topic Submissions](#)

Dear Ms. Lewis,

My name is Bill Harrington. I am writing to nominate myself as a member of the CFTC Market Risk Advisory Committee (MRAC). I provide biographical information further below in this letter.

At least 30 of my colleagues, professional contacts, friends, and family have also nominated me to be a MRAC member. These endorsements of my advocacy to rectify a root cause of the financial crisis — under-capitalized derivative contracts and asset-backed securities (ABS) — are deeply gratifying.

More importantly, these endorsements demonstrate what is both best in our country and critical to its wellbeing — people who pro-actively build their futures and everyone else's. To build these futures, the MRAC must include people such as me who are dedicated to examining the financial crisis clearly, free of blinders such as professional and partisan affiliations.

My work examines the capitalization and regulation of derivative contracts and structured finance. I focus on the swap type that was a core feature of many ABS that started and fueled the financial crisis — an uncleared and non-margined swap with a flip clause, replacement provisions, and rating agency conditions (ABS flip clause swap).

The ABS flip clause swap has long been the go-to hedging contract of ABS issuers around the world because it facilitates them in under-capitalizing deals. I have examined ABS flip clause

swaps since 1999 and consider them to be among the financial instruments that most undermine financial sustainability.

ABS counsel, investors, rating agencies, and regulators have long known just how destructive an ABS flip clause swap can be. A nine-year proceeding in the Lehman bankruptcy case regarding ABS flip clause swaps pitted the estate of Lehman Brothers against 200-plus investors, three of the largest US banks, and counsel at 22 law firms. The estate of Lehman Brothers, which may appeal, lost 100% of swap assets equal to USD 1BN.¹

In short, ABS flip clause swaps belong in the dustbin of failed products along with other synthetic concoctions such as aerosol sprays, asbestos tiles and trans fats.

MRAC Study of ABS Flip Clause Swaps and Other Rated Instruments

I am also writing to propose three inter-related topics “for the MRAC to prioritize in making recommendations to the CFTC on how to improve market structure and mitigate risk.”²

1. The necessity that the CFTC **NOT** issue exemptions to the margin rules for uncleared swaps³ to any end users, particularly to asset-backed security (ABS) deals.⁴

The CFTC margin rules for uncleared swaps are admirably airtight with respect to both the definition of “financial end user” and the types of assets that can and cannot be applied to margin requirements.

The CFTC swap margin rules serve the public interest in many ways and must remain intact, i.e., impressively comprehensive and airtight. A *short* list of public interest benefits includes: protecting investors; aiding price discovery; directing capital to optimal uses; reducing hard-to-detect taxpayer subsidies of over-the-counter swaps; limiting the prospects of future implicit and explicit taxpayer support for over-the-counter swaps, and preventing ABS issuers from entering into new ABS flip clause swaps.

Congress intended for these public interest benefits to be permanent and provided a mechanism to ensure that this would be the case; namely, binding the CFTC and SEC to

¹ Dave Simpson, "[Bankruptcy Court's Block Of \\$1B Lehman Clawback Upheld,](https://dlbjbjzgnk95t.cloudfront.net/1022000/1022435/https-ecf-nysd-uscourts-gov-doc1-127122046923.pdf)" *Law360*, March 14, 2018. The holding in the case, *Lehman Brothers Holding, Inc. et al vs. Bank of America National Association, et al.* 1:17-cv-01224, is available at: <https://dlbjbjzgnk95t.cloudfront.net/1022000/1022435/https-ecf-nysd-uscourts-gov-doc1-127122046923.pdf>.

² US Commodity Futures Trading Commission, *Market Risk Advisory Committee, Notice: Request for nominations and topic submissions* (Dec. 18, 2015), [83 Fed. Reg. 11507-8 (March 15, 2018)], <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2018-05271a.pdf>.

³ US Commodity Futures Trading Commission, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* (Dec. 18, 2015), [81 Fed. Reg. 636 (Jan. 6, 2016)], <https://www.gpo.gov/fdsys/granule/FR-2016-01-06/2015-32320>.

⁴ Bill Harrington, "[Existing ABS swaps also caught in swap margin net,](#)" *Debtwire ABS*, August 12, 2016. ABS industry groups such as the Structured Finance Industry Group (SFIG) repeatedly lobby the CFTC, other regulators, and Congress to exempt ABS issuers from the swap margin rules. See items on the "[Derivatives Taskforce](#)" tab of the [SFIG website](#). **N.B.** I was a member of the SFIG Derivatives Taskforce from May 13, 2013 to December 31, 2013. Thereafter, SFIG declined to renew my membership.

enforce Title VII activities without granting exemptions.⁵

Unfortunately, the Treasury strongly advocates that Congress harm the country by passing legislation to undo the respective binding provisions⁶ so that the CFTC could exempt swap providers under its purview from requiring financial end users such as ABS issuers to post margin.⁷

The CFTC should grant no exemptions to the rules. The ABS flip clause swap provides a perfect example of a type of swap, financial end user, and industry that should be fully subject to the swap margin rules.

2. The necessity that *NO* swap dealer and *NO* ABS deal or other end user enter into the type of swap that started and fueled the financial crisis — an uncleared and non-margined swap with a flip clause, replacement provisions, and rating agency conditions (ABS flip clause swap).⁸
3. The systemic damage that nationally recognized statistical rating organizations (NRSROs) such as DBRS, Fitch Ratings, Moody’s Investors Service, and S&P Global Ratings create in inflating the ratings of cleared derivative contracts, clearinghouses, uncleared cleared derivative contracts, and swap dealers by using the assumption of implicit and explicit government support.⁹

⁵ US Department of the Treasury, ["A Financial System that Creates Economic Opportunities,"](#) 179 (HTML 189). "Dodd-Frank amended CEA Section 4(c)(1) and Exchange Act Section 36(c) to limit the agencies’ [CFTC and SEC] ability to exempt many of the activities covered under Title VII. Limitations on the exemptive authority with respect to the swaps requirements of Dodd-Frank was perhaps a measure to ensure that the agencies, while writing rules and implementing the new regulatory framework, did not unduly grant exemptions."

⁶ *Ibid.*, 215 (HTML 225). "Treasury would support a legislative amendment to CEA Section 2(h)(7) providing the CFTC with rulemaking authority to modify and clarify the scope of the financial entity definition and the treatment of affiliates... Any legislative amendment should provide the SEC analogous rulemaking authority under Exchange Act Section 3C(g) with respect to exceptions from the clearing requirement for security-based swaps."

⁷ *Ibid.*, 141 (HTML 151). "Since passage of Dodd-Frank, there have been numerous proposals to modify the definition of financial entity and clarify the scope of the exception for nonfinancial end users’ affiliates... For example, certain commercial enterprises use *special purpose vehicles* [italics added] and similar subsidiary structures to engage in derivatives transactions."

⁸ I am one of the few researchers worldwide to have published pre-crisis analysis and follow-up post-mortems of ABS flip clause swaps. For a comprehensive compilation of my work in assessing rating methodologies for ABS flip clause swaps and other derivative contracts from 1999-2013. See William J. Harrington, [Electronic Letter to the US Securities and Exchange Commission "Re: Rule Comment No. 4-661"](#) (June 3, 2013), 1-152. Also, Bill Harrington, [US Financial Regulators Balk at Examining Complex Finance](#), *Croatan Institute Views*, February 8, 2018. Also, William J. Harrington, [Electronic Letter to CFTC Secretary Christopher Kirkpatrick Re: CFTC Letter No. 17-52](#) (February 2, 2018). Wikirating.org posted this letter on February 3, 2018. Also, William J. Harrington, [Submission to the US Commodity Futures Trading Commission "Re: RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants'"](#) (May 4, 2017). Also, Bill Harrington, ["Green STORM RMBS and ABS Flip Clause Swaps,"](#) Author’s LinkedIn profile, February 28, 2018.

⁹ Bill Harrington, ["Moody’s bets Germany will support Deutsche Bank derivatives above all else,"](#) *Debtwire ABS*, October 12, 2016. Also, William J. Harrington, [Electronic Letter to the US Securities and Exchange Commission "Re:](#)

As one example, the respective methodologies of all credit rating agencies specify the common template that assigns AAA-ratings to senior ABS when a deal is party to any type of ABS flip clause swap, including one that exchanges two currencies for 35 years. However, no methodologies that the author has reviewed track and tally the exposures that ABS flip clause swaps or derivative contracts in general create for investors, a financial institution, or the whole financial system, i.e., the public at large.

This collective omission by all NRSROs is intentional and leaves the broader society to underwrite the costs of ABS flip clause swaps and other derivative contracts.

Two Emails, Each Delivering MRAC Attachments

I have sent two emails with materials, including this letter, that collectively form my self-nomination to the MRAC, my proposals on how to improve market structure and mitigate market risk, and supporting materials for the foregoing.

The delivering email for this letter is titled “Market Risk Advisory Committee, Commodity Futures Trading Commission, Nomination and Topic Submission WJH1.”

The delivering second email is entitled “Market Risk Advisory Committee, Commodity Futures Trading Commission, Nomination and Topic Submission WJH2.” This second email contains four PDF attachments.

1. My CV;
2. The Moody’s methodology for ABS flip clause swaps and US Collateralized Debt Obligations “Moody’s Approach for Rating Thresholds of Hedge Counterparties in CDO Transactions” of October 23, 2002. I developed and co-authored this methodology, which was in force until May 25, 2006;
3. The Moody’s methodology for ABS flip clause swaps for all deals world wide “Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions” of May 25, 2006 (revised to incorporate minor details on October 18, 2010.) I developed and co-authored this methodology (Footnote 1, page 2), which was in force until November 13, 2013; and
4. The draft introduction to my upcoming white paper “Can Green Bonds Flourish in ABS Brownfield?”

[Rule Comment No. 4-661](#)” (June 3, 2013), 1-152. Also, Bill Harrington, ["Moody’s DOJ Settlement Won’t Stop Fake Rating Analysis & Derivatives Denial,"](#) Author’s LinkedIn profile, January 14, 2017. Also, Norbert J. Gaillard and William J. Harrington, “Efficient, commonsense actions to foster accurate credit ratings,” *Capital Markets Law Journal* 11, No.1 (2016): 38-59, [https://doi: 10.1093/cmlj/kmv064](https://doi:10.1093/cmlj/kmv064). **N.B.** The Capital Markets Law Journal kindly allows the author to provide a free-access link to the article on his [biography page](#) on the Croatan Institute website. Until recently, [the article was also posted](#) on the website of the US Senate Committee on Banking, Housing and Urban Affairs.

Biographical Information

“MRAC members generally serve as representatives and provide advice reflecting the views of organizations and entities that constitute the structure of the derivatives and financial markets...Historically, the MRAC has had approximately 30 members with the following types of entities with interests in the derivatives markets and systemic risk being represented: (i) Exchanges, (ii) clearinghouses, (iii) swap execution facilities, (iv) swap data repositories, (v) intermediaries, (vi) **market makers**, (vii) **service providers**, (viii) **end-users**, (ix) **academia**, (x) **public interest groups** [bold italic added], and (xi) regulators.”¹⁰

...

“To advise the Commission effectively, MRAC members must have a **high-level of expertise and experience in the derivatives and financial markets and the Commission’s regulation of such markets, including from a historical perspective** [bold italic added]. To the extent practicable, the Commission will strive to select members reflecting wide ethnic, racial, gender, and **age** [bold italic added] representation. **MRAC members should be open to participating in a public forum** [bold italic added].”

Regarding my credentials and personal qualities that dovetail with the above MRAC specifications — I have worked for derivative market makers, service providers, end-users. I have co-authored a peer-reviewed law article and worked as a derivatives journalist for a specialist wire serve that serves hedge funds and financial counsel. I have pursued a singular public policy advocacy entirely in the public domain.

All my work, including my advocacy, is in the publicly available. Please see my LinkedIn profile, <https://www.linkedin.com/in/williamjharrington/>.

Please also see my biography on the website of the Croatan institute, where I am a senior fellow. <http://croataninstitute.org/william-j-harrington>.

“Bill Harrington is a Senior Fellow at Croatan Institute. His work centers on boosting the sustainability of the world financial system with the dual aims of rationalizing economic decision-making and avoiding bailouts. He focuses on the capitalization and regulation of derivative contracts and structured finance.

“Bill has evaluated products in the international financial markets since 1987, most recently as a research journalist at Debtwire ABS and before that as a senior vice president and derivatives analyst at Moody's Investors Service (Moody's). He also structured derivative contracts that referenced currencies and global interest rates at Merrill Lynch and analyzed the trading patterns of these indices as an economist at The WEFA Group.

“Since 2011, Bill has worked to rectify the under-capitalization of the types of complex finance that started and fueled the financial crisis. He has submitted technical comments to US and European regulators, to US and UK legislative committees, and to rating agencies such as Fitch

¹⁰ US Commodity Futures Trading Commission, *Market Risk Advisory Committee, Notice: Request for nominations and topic submissions* (Dec. 18, 2015), [83 Fed. Reg. 11507-8 (March 15, 2018)], <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2018-05271a.pdf>.

Ratings, Moody's, and S&P Global. Bill also provided insights regarding Moody's rating practices to the US state attorneys general who settled with the company in early 2017.”

Conclusion

Please do not hesitate to call or otherwise contact me to discuss my self-nomination and proposals of three inter-related topics “for the MRAC to prioritize in making recommendations to the CFTC on how to improve market structure and mitigate risk.”

Best regards,

William J. Harrington

Senior Fellow, [Croatan Institute](#)

[Wikirating.org](#) Experts Board — Structured Finance Topics