FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

September 14, 2015

Honorable Elijah E. Cummings
Ranking Minority Member
Committee on Oversight and Government Reform
House of Representatives
Washington, D.C. 20515

Dear Congressman Cummings:

Thank you for your letter regarding section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and amendments to it that were enacted in December 2014.

As originally enacted, section 716 prohibited federal assistance to a swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity.[1] With respect to the Federal Deposit Insurance Corporation, federal assistance includes FDIC insurance or guarantees for the purpose of (A) making any loan to, or purchasing any stock, equity interest, or debt obligations of, any swaps entity; (B) purchasing the assets of any swaps entity; (C) guaranteeing any loan or debt issuance of any swaps entity; or (D) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

Title VII of the Dodd-Frank Act established a new regulatory regime for transactions meeting the definition of swap and security-based swap and required the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) to establish registration requirements for dealers and major participants in swaps and security-based swaps. The term swaps entity is defined as any swap dealer, security-based swap dealer, major swap participant, or major security-based swap dealer registered under the Commodity Exchange Act or the Securities Exchange Act of 1934. As of August 24, 2015, 15 insured depository institutions have registered as swap dealers with the CFTC (IDI swap dealers).[2] The SEC recently adopted final registration requirements for security-based swap dealers but such requirements have not yet taken effect.[3]

As enacted, section 716 provided a safe harbor from the prohibition against federal assistance for swaps entities that are insured depository institutions so that the prohibition did not apply if such an institution limited its swap activities to: (1) hedging or other risk mitigating activities related to the institution's activities; and (2) acting as swap entity for swaps involving

[1] 15 U.S.C. 8305(a).
[2] http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.
[3] 80 FR 48964 (August 14, 2014).

rates or reference assets that are permissible for investment by a national bank under 12 U.S. § 24(Seventh), excluding uncleared credit default swaps.

Earlier this year, the safe harbor for insured depository institutions was amended.[4] Under the revised safe harbor, the prohibition against federal assistance would not apply to an institution that limited its swap activities to: (1) hedging or other risk mitigating activities; and (2) acting as a swaps entity for swaps other than structured finance swaps, unless the structured finance swap is undertaken for hedging or risk management purposes or each asset backed security underlying the structured finance swap is of a credit quality and of a type or category with respect to which the prudential regulators have jointly adopted rules authorizing swap activity by covered depository institutions.

Concerning affiliates, section 716 provides that the prohibition against federal assistance does not apply and shall not prevent an insured depository institution from having or establishing an affiliate that is a swaps entity, as long as such IDI is part of a bank holding company, savings and loan holding company, or foreign banking organization that is supervised by the Federal Reserve, and such swaps entity affiliate complies with section 23A and 23B of the Federal Reserve Act and such other requirements as the CFTC, SEC, and the Board of Governors of the Federal Reserve System may deem necessary.

In your letter, you pose several questions regarding the application of section 716 and about the swap activity of insured depository institutions that are swaps entities. Below are responses prepared by FDIC staff.

Q1: The definitions of the terms "hedging" and "risk management purposes" that your agency will use to determine which swaps trades can now be made under Section 716.

A1: The federal banking agencies developed closely related definitions for "risk-mitigating" and "risk-mitigating hedging activities" in implementing the Volcker Rule. The FDIC has not determined whether modifications to these definitions are needed for purposes of section 716.

Q2: The total value of derivatives contracts held by U.S. banks for "hedging" and "risk management purposes" and the total value of swaps derivatives held by U.S. banks for each purpose.

A2: The enclosed Table 1 reflects information from the 15 IDI swap dealers regarding their total derivatives activities as of December 31, 2014 (inclusive of hedging, risk management, and market making activities). For each of these institutions, Table 1 also reflects the level of derivatives activities for the related bank holding company as of the same date.[5]

[4] Pub.L. 113-325, §630 (December 15, 2014).

[5] The information in Table 1 comes from data reported by Insured Depository Institutions in the Call Reports and by bank holding companies in the forms Y-9C submitted to the Federal Reserve Board.

Table 1 reflects that as of December 31, 2014, the 15 IDI swap dealers had, with their subsidiaries, outstanding derivatives with notional amounts of $219.3 trillion. As of the same date, the bank holding companies with which these 15 IDI swap dealers are related had outstanding derivatives with notional amounts of $287.3 trillion. As of the same date, all other insured depository institutions and their subsidiaries had outstanding derivatives with notional amounts of $1 trillion with the related bank holding companies for these other insured depository institutions having outstanding derivatives with notional amounts of $1.7 trillion. The combined notional amount for the outstanding derivatives at all insured depository institutions and their subsidiaries is $220.4 trillion, and the amount for all bank holding companies is $289 trillion.

With regard to your request for the value of derivatives contracts held by U.S. banks solely for hedging and risk management purposes, information reported by insured depository institutions and bank holding companies does not currently provide their derivatives activities in a manner that allows for such a determination.

Q3: The definition of the term "structured finance swap" that your agency will use to determine which swaps trades can now be made under Section 716 and examples of the types of transactions that will now be allowed.

A3: Section 716, as amended, defines structured finance swap as a swap or security-based swap based on an asset-backed security (or group or index primarily comprised of asset-backed securities).[6] The term "asset-backed security" is defined by section 716 to have the meaning given such term under section 3(a) of the Securities Exchange Act of 1934, which provides the following definition:

> (77) Asset-Backed Security.—The term "asset-backed security"—
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> (A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including—
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> (i) a collateralized mortgage obligation,
> (ii) a collateralized debt obligation;
> (iii)a collateralized bond obligation;
> (iv) a collateralized debt obligation of asset backed securities;
> (v) a collateralized debt obligation of collateralized debt obligations; and
> (vi) a security that the [Securities and Exchange Commission], by rule, determines to be an asset-backed security for purposes of this section; and
>
> (B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities

[6] 15 U.S.C. §8305(d)(2)(A).

issued by the finance subsidiary are held by an entity that is not controlled by the parent company.[7]

The agencies are continuing to analyze the various types of examples of swaps that are based on asset-backed securities.

Q4: The total value of "structured finance swap" transactions conducted by U.S. banks for the last ten years, by bank and by year.

A4: Based on the statutory definition of an asset-backed security, a structured finance swap would most likely fall into the broader category of credit derivatives. Derivatives information reported by insured depository institutions in the Call Report, however, does not indicate which swaps are based on an asset-backed security (or group or index primarily comprised of asset backed securities). Accordingly, we cannot provide the information requested.

Q5: The total value of swaps U.S. banks would have been required to "push out" under Section 716 as originally adopted.

A5: By its terms, section 716 applies only to swaps or security-based swaps entered into by an IDI swaps entity after the end of the applicable transition period.[8] It is FDIC staff's understanding that each of the 15 IDI swap dealers were granted two year transition periods by their respective primary federal regulator and that these transition periods expired on July 16, 2015. So for an IDI swap dealer, the prohibition would only apply if it failed to limit its swap activities to hedging and swaps other than structured finance swaps after that date.

Had section 716's safe harbor not been amended earlier this year, an IDI swap dealer would have had to limit its non-hedging swap activity to a narrower set of swaps. For example, under section 716 as originally enacted, after the expiration of the transition period, an IDI swap dealer would have had to limit its non-hedging swaps activity to swaps that reference rates, e.g., interest rate swaps, and swaps that reference assets permissible for investment by a national bank. This would appear to preclude non-hedging swaps that reference, for example, equities and commodities other than bullion (e.g., gold and silver) as well uncleared credit default swaps not entered into for hedging purposes.

The enclosed Table 2 provides information about the derivatives activity as of December 31, 2014, of the 15 IDI swap dealers and their subsidiaries by product: interest rate derivatives, foreign exchange derivatives, credit derivatives, equity derivatives, and commodity derivatives. Table 2 also shows the value of such derivatives categories at the bank holding companies related to these 15 IDI swap dealers.

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[7] 15 U.S.C. 78c(a)(79).

[8] 15 U.S.C. §8305(e).

The original terms of section 716 did not require the immediate push-out of all this activity. Much of the activity was in swaps not required to be pushed out under section 716 (e.g., interest rate swaps). Of the remaining activity, some was for hedging purposes and a portion of credit derivatives was centrally cleared, as discussed below. Moreover, since the information below is as of year-end 2014, presumably all the swaps reported were entered into before the end of the transition period. The original section 716 would have influenced where covered swaps activities could be booked as they were replaced, and thus would have influenced the locus of swaps activity over time. In addition, some institutions may have decided to push-out some pre-existing swaps, even though they were technically not required to do so, based on other business considerations.

Interest Rate Derivatives

For interest rate derivatives, Table 2 indicates that the 15 IDI swap dealers and their subsidiaries reported notional activity of $173.0 trillion. Given that interest rate swaps would have been within the safe harbor under section 716 as originally enacted, this activity would largely have been unaffected by the prohibition regardless of whether it was engaged in for hedging purposes or not.

Foreign Exchange Derivatives

The 15 IDI swap dealers and their subsidiaries reported outstanding foreign exchange derivatives activity with a notional value of $33.1 trillion. Foreign exchange swaps and foreign exchange forwards among this activity would not have been subject to the prohibition as originally adopted due to the Secretary of the Treasury's determination on November 12, 2012, to exempt such transactions from the definition of "swap."

Credit Derivatives

Credit derivatives at the 15 IDI swap dealers and their subsidiaries had a notional value of $9.4 trillion at year-end 2014. Available information from Call Reports suggests that $6.1 trillion or more of this total was not cleared and would have been required to be pushed out if not entered into before the end of the transition period or unless the activity fell within the hedging exemption.

Also, 11 of the 15 bank holding companies that own the 15 IDI swap dealers report the vast majority (96 percent or more) of their credit derivatives activity being transacted out of the IDI swap dealer. Two bank holding companies, out of which credit derivatives activity representing the second and fifth highest volume of such activity among the 15 U.S. bank holding companies that own IDIs registered as swap dealers, report that the vast majority of this activity is conducted in a subsidiary that is not an IDI. The activity within these two U.S. bank holding companies strongly suggest that credit derivatives activity conducted out of IDI swap dealers at the other 11 bank holding companies that would have been subject to the prohibition can successfully be pushed out to a non-IDI affiliate or financial subsidiary.

Commodity Derivatives

With respect to commodity derivatives, the 15 IDI swap dealers and their subsidiaries had outstanding activity with a notional value of $1.2 trillion. As indicated in Table 3, Call Report data suggests that approximately 80 percent of total commodity derivatives activity within the 15 IDI swap dealers and their subsidiaries is associated with commodity contract types other than precious metals, and thus presumably would have been pushed out under the exemption in section 716 as originally adopted (unless entered into before the end of the transition period or for hedging purposes). Call Report data does not allow for an estimation of the percentage that would have qualified for the hedging exemption.

Equity Derivatives

For derivatives that reference equities, Table 2 shows that the 15 IDI swap dealers and their subsidiaries reported outstanding contracts with a notional value of $2.6 trillion. Call Report data does not indicate what percentage of this activity is engaged in for hedging that would have qualified for the hedging exemption. Thirteen of the 15 bank holding companies that own the 15 IDI swap dealers that are registered as swap dealers participate in equity swaps transactions, with eight reporting the vast majority (86 percent or more) of their equities swaps contracts being transacted out of their IDI swap dealer or subsidiaries of the IDI. Of the five remaining bank holding companies that engage in equities derivatives transactions, three report almost all equities swaps activity outside of their IDI. Notably, these include the second and third most active banking organizations in the equities derivatives market as measured by the notional value of their equities derivatives transactions.

Q6: Any estimates concerning the total value of swaps U.S. banks will now be required to "push out" under the revised Section 716.

A6: As described earlier, in general, the banking agencies do not currently require reporting on structured finance swaps but we anticipate the amount of structured finance swaps that would be pushed out under the revised section 716 would be relatively small.

Q7 through 10: Any assessments conducted by the FDIC regarding: [a] the "operational and credit risks" the implementation of Section 716 would have created for U.S. banks; [b] the impact of the partial repeal on the risk of taxpayer-funded bailouts of insured depository institutions; [c] the impact of the partial repeal on bank behavior in the swaps derivatives market generally, including an assessment of whether or how the partial repeal of Section 716 increases the risk profiles of major banks; and, [d] the risks to the U.S. economy created by the partial repeal of Section 716.

A7 - 10: Generally speaking, large volumes of derivatives activity conducted by an IDI would be expected to increase its risk profile. Quantifying the types of issues described in your questions, however, is difficult; and the FDIC has not conducted these types of assessments.

In your letter, you also request the FDIC to evaluate how the amendments to section 716's safe harbor will affect the implementation of sections 23A and 23B of the Federal Reserve Act.

As you note, Section 23A establishes quantitative limits to covered transactions between a bank and its affiliates. Section 23B generally requires that transactions between a bank and its affiliate occur on market terms, among other requirements. With rare exceptions a subsidiary of a bank is not covered by the definition of "affiliate" under sections 23A and 23B, so transactions between a bank and its subsidiary are in general exempt from those sections' requirements[9] except by order of the relevant primary regulator.

It is not clear how the changes to section 716's safe harbor for IDI swap dealers will affect transactions between an IDI swap dealer and its affiliates and how sections 23A and 23B will apply to those transactions. On the one hand, an IDI swap dealer will be permitted to engage in swaps with its affiliates that had previously been outside of section 716's safe harbor but are now permitted. On the other hand, section 23A would place some limits on the credit exposure, including the credit exposure from derivatives transactions, between an IDI and affiliates other than subsidiaries of the IDI (with rare exceptions). However, it should be noted that the quantitative limits set by section 23A on derivatives transactions could depend in large part on the current market value of the derivative as well as any posted collateral.

I also appreciate you sharing your concern that the margin rule the FDIC and the other prudential regulators proposed in September 2014 would give banks an incentive to transfer derivatives transactions to federally insured institutions in order to lower the amount of margin required. The prudential regulators will carefully consider this aspect of the proposed rule when we consider a final rule.

Thank you again for your interest in information related to section 716 and its recent amendments. If you have additional questions, please contact me at (202) 898-3888, or Eric Spitler, Director, Office of Legislative Affairs, at (202) 898-7140.

Sincerely,

Martin J. Gruenberg

Martin J. Gruenberg

Enclosures

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[9] 12 U.S.C. §371c(b)(2)(A).

Table 1. For 15 IDIs registered as Swap Dealers with the CFTC as of August 24, 2015, comparison of notional values of outstanding derivatives contracts within the Bank Holding Company that owns the insured depository institution with such contracts that are transacted at the insured depository institution registered as a Swap Dealer or at subsidiaries of insured depository institutions.

Notional Amount of Swaps Contracts as of 2014 Q4 ($Billions)			
	NOTIONAL AMOUNT OF CONTRACTS WITHIN BHCs	NOTIONAL AMOUNT OF CONTRACTS AT IDIs AND THEIR SUBSIDIARIES	PERCENTAGE OF BHC ACTIVITY LOCATED IN IDIs AND THEIR SUBSIDIARIES
JPMORGAN	$63,600	$63,683	100%
CITIBANK	$59,952	$56,298	94%
GOLDMAN SACHS	$57,313	$46,779	82%
BANK OF AMERICA	$54,224	$36,726	68%
MORGAN STANLEY	$38,547	$2,133	6%
WELLS FARGO	$5,302	$5,369	101%
HSBC	$4,776	$4,773	100%
BONY MELLON	$1,249	$1,237	99%
STATE STREET	$1,235	$1,232	100%
PNC	$340	$346	102%
NORTHERN TRUST	$253	$253	100%
SUNTRUST	$232	$233	100%
USB	$139	$136	98%
KEYBANK	$65	$62	95%
FIFTH THIRD	$63	$61	97%
TOTAL 15 BHC and IDI SDs	**$287,290**	**$219,322**	**76%**
TOTAL All Other BHCs and IDIs	**$1,722**	**$1,040**	**60%**
Total for All U.S. Institutions	**$289,011**	**$220,362**	**76%**

Data Source: FR Y-9C, schedule HC-L; and Call Report, schedule RC-L
*Note: Information reported for insured depository institutions includes activity level at all subsidiaries of the IDI.

Table 2: For 15 IDIs registered as Swap Dealers with the CFTC as of August 24, 2015, comparison of notional values of outstanding derivatives contracts within the Bank Holding Company that owns the IDI with such contracts that are transacted at the IDI registered as a Swap Dealer or at subsidiaries of IDIs

Notional Amount of Derivatives Contracts as of 2014 Q4 ($Billions)																	
Derivatives Contract Type		JPM	CITI	GS	BAC	MS	WFC	HSBC	BK	STT	PNC	NTRS	STI	USB	KEY BANK	FIFTH THIRD	TOTAL 15 BHC and IDI SDs
Interest Rate Contracts	Total Interest Rate Contracts within BHC	$48,085	$46,053	$47,243	$43,070	$31,057	$4,749	$3,339	$755	$11	$317	$10	$172	$95	$59	$40	**$225,055**
	Total Interest Rate Contracts at IDI*	$47,992	$43,001	$44,306	$28,095	$31	$4,810	$3,338	$743	$8	$323	$11	$172	$92	$56	$38	**$173,016**
	Percentage of BHC Activity Transacted from IDI Swap Dealer*	**100%**	**93%**	**94%**	**65%**	**<1%**	**101%**	**100%**	**98%**	**74%**	**102%**	**107%**	**100%**	**97%**	**96%**	**96%**	**77%**
Foreign Exchange Contracts	Total Foreign Exchange Contracts within BHC	$9,524	$9,576	$5,370	$7,236	$3,927	$290	$1,098	$483	$1,201	$16	$243	$5	$40	$4	$16	**$39,029**
	Total Foreign Exchange Contracts at IDI*	$9,538	$9,789	$2,202	$6,061	$2,097	$308	$1,102	$484	$1,200	$16	$243	$5	$40	$4	$16	**$33,106**
	Percentage of BHC Activity Transacted from IDI Swap Dealer*	**100%**	**102%**	**41%**	**84%**	**53%**	**106%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**85%**
Credit Derivatives	Total Credit Derivatives within BHC	$4,246	$2,180	$2,501	$2,274	$1,852	$29	$243	$0	<$1	$5	$0	$5	$4	$1	$1	**$13,340**
	Total Credit Derivatives at IDI*	$4,247	$2,486	$226	$2,186	$5	$31	$243	$0	<$1	$5	$0	$5	$4	$1	$1	**$9,439**
	Percentage of BHC Activity Transacted from IDI Swap Dealer*	**100%**	**114%**	**9%**	**96%**	**<1%**	**106%**	**100%**	**NA**	**100%**	**100%**	**NA**	**96%**	**111%**	**100%**	**100%**	**71%**
Equities	Total Equities within BHC	$1,062	$1,665	$1,527	$923	$1,213	$144	$60	$11	<$1	$2	$0	$50	<$1	$0	$2	**$6,659**
	Total Equities at IDI*	$1,254	$672	$36	$355	$0	$129	$55	$9	$0	$2	$0	$50	<$1	$0	$2	**$2,565**
	Percentage of BHC Activity Transacted from IDI Swap Dealer*	**118%**	**40%**	**2%**	**38%**	**0%**	**90%**	**91%**	**86%**	**0%**	**95%**	**NA**	**100%**	**91%**	**NA**	**100%**	**39%**
Comm-odities	Total Commodities within BHC	$682	$477	$671	$721	$498	$91	$35	$0	$23	$0	$0	$1	<$1	$2	$4	**$3,206**
	Total Commodities at IDI*	$652	$350	$8	$30	$0	$91	$35	$0	$23	$0	$0	$1	<$1	$1	$4	**$1,195**
	Percentage of BHC Activity Transacted from IDI Swap Dealer*	**96%**	**73%**	**1%**	**4%**	**0%**	**101%**	**99%**	**NA**	**100%**	**NA**	**NA**	**100%**	**74%**	**42%**	**100%**	**37%**
TOTAL	**TOTAL NOTIONAL AMOUNT OF CONTRACTS AT BHC**	**$63,600**	**$59,952**	**$57,313**	**$54,224**	**$38,547**	**$5,302**	**$4,776**	**$1,249**	**$1,235**	**$340**	**$253**	**$232**	**$139**	**$65**	**$63**	**$287,290**
	TOTAL NOTIONAL AMOUNT OF CONTRACTS AT IDI*	**$63,683**	**$56,298**	**$46,779**	**$36,726**	**$2,133**	**$5,369**	**$4,773**	**$1,237**	**$1,232**	**$346**	**$253**	**$233**	**$136**	**$62**	**$61**	**$219,322**
	PERCENTAGE OF BHC ACTIVITY TRANSACTED FROM IDI*	**100%**	**94%**	**82%**	**68%**	**6%**	**101%**	**100%**	**99%**	**100%**	**102%**	**100%**	**100%**	**98%**	**95%**	**97%**	**76%**

Data Source: FR Y-9C, schedule HC-L; and Call Report, schedule RC-L

***Note:** Information reported for IDIs includes activity level at all subsidiaries of the IDI.

Table 3: For 15 IDIs Registered as Swap Dealers with the CFTC as of August 24, 2015, Classification of Commodities Contracts*

	Total Commodities	Precious Metals	Other Commodities	Percentage of Commodities Contracts that are Classified as Other than Precious Metals in IDIs and their Subsidiaries
JPMORGAN	$285,786	$59,869	$225,917	79%
CITIBANK	$150,834	$14,939	$135,895	90%
GOLDMAN SACHS	$7,519	$20	$7,499	100%
BANK OF AMERICA	$23,132	$0	$23,132	100%
MORGAN STANLEY	$0	$0	$0	NA
WELLS FARGO	$34,378	$487	$33,891	99%
HSBC	$31,155	$30,966	$189	1%
BONY MELLON	$0	$0	$0	NA
STATE STREET	$0	$0	$0	NA
PNC	$0	$0	$0	NA
NORTHERN TRUST	$0	$0	$0	NA
SUNTRUST	$598	$10	$588	98%
USB	$333	$0	$333	100%
KEYBANK	$441	$0	$441	100%
FIFTH THIRD	$2,171	$0	$2,171	100%
TOTAL 15 BHC and IDI SDs	$536,347	$106,291	$430,056	80%

Data Source: Call Report, Schedule RC-R, 2014 Q4

*Note: Dollar amounts in Millions. Figures above exclude any contracts not subject to risk-based capital requirements, such as foreign exchange contracts with an original maturity of 14 days or less, futures contracts, written options, and basis swaps. Therefore, the total notional amount of Commodities Contracts above will not add to total Commodities Contracts figures elsewhere in this report.