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RANKING MINORITY MEMBER

Congress of the United States

House of Representatives

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July 16, 2015

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th St NW
Washington, DC 20429

Dear Chairman Gruenberg:

We are writing to request that you provide us with information that will help the American people—and those they have elected to represent them—understand the risks that the partial repeal of Section 716 of the Dodd-Frank Act has created for taxpayer-insured depository institutions and ultimately for the taxpayers themselves. Without this understanding, the country risks moving blindly toward the same financial meltdown that plunged the economy into recession seven years ago.

Although we attempted to obtain this information directly from many of the banks most directly affected by the partial repeal of Section 716, they did not provide the information necessary to assess the risks taxpayers face when these banks engage in swaps transactions using federally insured funds. Instead, many of the banks claimed that this was proprietary information that they should withhold from Congress and the public for competitive reasons.

We believe that if these banks want continued access to federally insured deposit funds, they must be more transparent about the risks they are taking with that money. If they want to keep secret the risks they are taking, these banks should forfeit access to taxpayer-backed FDIC insurance. They can have access to taxpayer guarantees or they can keep big secrets, but they can't do both.

Without clear, quantifiable information on the increased risks taxpayers face because of the changes to Section 716, it is impossible for Congress and the American people to evaluate the risks we face. Set forth below is additional detail about our request.

Background on Repeal of Section 716 of Dodd-Frank Act

In December 2014, Congress passed the 2015 Consolidated and Further Continuing Appropriations Act. In the final days of considering the Act, the House inserted a provision to gut a Dodd-Frank provision designed to prevent Federal Reserve and FDIC bailouts to swaps entities and banks with swaps holdings.

Under Section 716 of the Dodd-Frank Act, insured depository institutions were required to "push out" certain swaps transactions to separate subsidiaries that did not and could not benefit from a government backstop.[1] The 2015 spending bill repealed key parts of this requirement.[2]

The potential impact of this action is enormous. Swaps derivatives transactions currently have a notional value of $117 trillion.[3] According to Nobel Prize-winning economist Joseph Stiglitz, these types of derivatives "played a key role in transforming a financial downturn into a global economic calamity."[4] And Nobel Prize-winning economist Paul Krugman warned that the partial repeal of Section 716 was a "significant" blow to financial reform that amounts to "letting Wall Street play games with government-guaranteed funds."[5]

In order to assess the magnitude of the new risks put on taxpayers caused by this partial repeal of Dodd-Frank, we wrote in January 2015 to the largest banks affected by this provision to request information about their swaps practices. We wrote to Bank of America, Citigroup, JPMorgan Chase & Co., and Goldman Sachs seeking information about how each bank would alter its swaps trading practices in response to the repeal of the swaps push out provision.[6] In our letters, we made six requests for specific information, including information on the total value of derivatives contracts and swaps derivatives each institution holds for "hedging" and "risk management" purposes, as well as the total value of swaps transactions each institution would have "pushed out" under Section 716 as originally enacted.

Refusal of Banks to Provide Requested Information

The banks failed to answer numerous questions and refused to provide sufficient information to enable us to evaluate how much more risk has been shifted to taxpayers as a result

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[1] Pub. L. 111-203, §716.

[2] Pub. L. 113-235, §630.

[3] Office of the Comptroller of the Currency, OCC's Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2015 (2015) (online at http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq115.pdf).

[4] Letter from Joseph E. Stiglitz to United States Senate (May 14, 2010) (online at www.peri.umass.edu/fileadmin/pdf/other_publication_types/SAFERbriefs/Stiglitz_Lincoln_amendmentMay14.pdf).

[5] *Wall Street's Revenge,* New York Times (Dec. 14, 2014) (online at www.nytimes.com/2014/12/15/opinion/paul-krugman-dodd-frank-damaged-by-the-budget-bill.html?_r=0).

[6] Letters from Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform, to Bank of America, JPMorgan Chase, Citibank, and Goldman Sachs (Jan. 29, 2015) (online at http://democrats.oversight.house.gov/news/press-releases/warren-and-cummings-ask-banks-about-swaps-trading-practices-after-key-section-of).

of the repeal of this key Dodd-Frank provision. Instead, the banks provided only conclusory statements similar to those they made when they lobbied for the rollback. In some cases, the banks also provided heavily redacted copies of the applications they filed with regulators seeking a transition period before Section 716 as enacted under Dodd-Frank would take effect.

Citigroup Response

Citigroup provided a written response to our requests on February 26, 2015 and provided a briefing on March 11, 2015. Citigroup did not provide any information about the total value of derivatives contracts or swaps derivatives it holds, nor did the company quantify the value of the transactions that would be affected by the repeal of Section 716. The bank claimed that Section 716 would have increased its costs, but it offered no documentation for the basis of its claim or estimates of the costs it would incur.[7]

Bank of America Response

Bank of America provided a written response to our requests on February 26, 2015, and provided a staff-level briefing on the same day. Bank of America did not provide any information about the total value of derivative contracts or swaps derivatives it holds, nor did the company quantify the value of the transactions that would have been affected by the repeal of Section 716. Bank of America asserted that quantifying the bank's derivatives portfolio based on "[n]otional amount significantly overstates risks and fails to account for how credit is managed and mitigated," but it provided no data about the risks associated with its derivatives portfolio.

Bank of America cited publicly available FDIC information to assert that "under the original Section 716 language, only approximately 2% of the aggregate mark-to-market exposure of all derivatives would have been pushed out of banks." Without knowing the total value of this mark-to-market derivatives exposure, however, it is not possible to discern the dollar value of this 2% figure for Bank of America and how it compares with the bank's capital reserves. Bank of America claimed that Section 716 would have increased its costs, but it offered no documentation for the basis of its claim or estimates of the costs it would incur.[8]

JPMorgan Chase & Co. Response

JPMorgan Chase & Co. provided a written response to our requests on February 26, 2015, and provided a briefing on March 19, 2014. JPMorgan did not provide any information

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[7] Letter from Carl V. Howard, Deputy General Counsel, Citigroup, to Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform (Feb. 26, 2015).

[8] Letter from John E. Collingwood, Director, Federal Government Relations, Bank of America, to Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform (Feb. 26, 2015).

about the total value of derivatives contracts or swaps derivatives it holds, nor did the company quantify the value of the transactions that would have been affected by the repeal of Section 716.[9] In a briefing to staff, JPMorgan indicated that the amount of structured finance swaps in its portfolio, which are still required to be "pushed out" under the amended Section 716, was an "order of magnitude" smaller than the amount of swaps activities it could house in its insured depository institution. However, JPMorgan refused to quantify either of these figures. The company claimed that Section 716 would have increased its costs, but it offered no documentation for the basis of its claim or estimates of the risks it would incur.[10]

<u>Goldman Sachs Response</u>

Goldman Sachs provided a briefing on February 5, 2015, and sent a written response to our requests on March 3, 2015. Goldman Sachs did not provide any information about the total value of derivatives contracts or swaps derivatives it holds, nor did the company quantify the value of the transactions that would have been affected by the repeal of Section 716.[11] Instead, the company wrote:

> Section 716 has a *de minimus* impact on the firm as our derivatives holdings in Goldman Sachs Bank USA ("GS Bank") that would have been subject to push-out absent the recent changes to Section 716 are quite small (at last calculation less than 0.6% of GS Bank's total swaps holdings).

The bank also wrote that its "swaps activity overwhelmingly consists of interest rate and currency derivatives that are not subject to Section 716" as originally drafted.[12] Goldman Sachs made no claim that compliance with Section 716 would have increased its costs.

Information Request

Because the information we requested bears directly on the safety of the banks, the risks forced on taxpayers, and the stability of the financial system as a whole, we are writing to you to request that you provide us with this information so we can evaluate it fully and fairly. Given the

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[9] Letter from Diane M. Genova, General Counsel, Corporate and Regulatory Law, JPMorgan Chase & Co., Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform (Feb. 26, 2015).

[10] Letter from Carl V. Howard, Deputy General Counsel, Citigroup, Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform (Feb. 26, 2015).

[11] Letter from Thomas S. Riggs, General Counsel, Goldman Sachs, to Ranking Member Elizabeth Warren, Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs, and Ranking Member Elijah E. Cummings, House Committee on Oversight and Government Reform (Mar. 3, 2015).

banks' refusal to provide the information we requested, we ask that you provide us with the following information:

(1) 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;

(2) 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;

(3) 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;

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

(5) The total value of swaps U.S. banks would have been required to "push out" under Section 716 as originally adopted;

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

(7) Any assessments conducted by your agency regarding the "operational and credit risks" the implementation of Section 716 would have created for U.S. banks;

(8) Any assessments conducted by your agency regarding the impact of the partial repeal of Section 716 on the risk of taxpayer-funded bailouts of insured depository institutions;

(9) Any assessments conducted by your agency regarding the impact of the partial repeal of Section 716 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

(10) Any assessments conducted by your agency regarding the risks to the U.S. economy created by the partial repeal of Section 716.

Additional Request on Federal Reserve Act and the Margin Rule

In addition to the requests listed above, we also request that you evaluate the potential impact of the partial repeal of Section 716 on the implementation of Sections 23A and 23B of the Federal Reserve Act and the forthcoming "margin rule." As you know, Section 23A imposes quantitative limits and qualitative standards on the types of transactions that can occur between banks and their affiliates.[13] Section 23A also limits such transactions to the equivalent of 10% of

[13] 12 U.S.C. § 371c.

a bank's capital stock.[14] Section 23B requires that these transactions occur on "market terms," meaning that the terms of the transactions mirror those in comparable transactions conducted outside the bank in the market.[15]

The Federal Reserve's forthcoming "margin rule" is intended to avoid the excessive leveraging in the derivatives market that contributed to the 2008 financial crisis.[16] According to the Federal Reserve, the margin rule "would establish minimum requirements for the exchange of initial and variation margin between covered swaps entities and their counterparties to non-cleared swaps and non-cleared security-based swaps."[17]

Following the implementation of the margin rule, banks will have an incentive to meet collateral requirements in the least expensive way possible—including by "pushing in" more derivatives transactions to federally insured institutions, which can house transactions at lower cost and thereby lower the amount of margin required. As the Federal Reserve has noted:

> The amount of margin that would be required under the proposed rule would vary based on the relative risk of the counterparty and of the non-cleared swap or non-cleared security-based swap.[18]

We request that you describe how the partial repeal of Section 716 will affect implementation of the requirements of the margin rule and Section 23A and Section 23B now that banks can continue originating a wider range of derivatives transactions inside federally insured institutions and now that fewer transactions will occur between a holding company and federally insured institutions as defined under Section 23A and Section 23B.

Please provide this information by August 6, 2015. If you have any questions about this request, please contact Brian Cohen in the office of Senator Elizabeth Warren at (202) 224-4543 or Lucinda Lessley with the Committee on Oversight and Government Reform Minority Staff at (202) 225-5051. Thank you for your cooperation with this matter.

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[14] *Id.*

[15] 12 U.S.C. § 371c-1.

[16] *See, e.g.*, Financial Stability Forum, *Report of the Financial Stability on Addressing Procyclicality in the Financial System* (Apr. 2009).

[17] Board of Governors of the Federal Reserve System, *Agencies Seek Comments on Swap Margin Requirements* (Sept. 3, 2014) (online at www.federalreserve.gov/newsevents/press/bcreg/20140903c.htm).

[18] *Id.*

Sincerely,

Elizabeth Warren
Ranking Member
Subcommittee on Economic Policy
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate

Elijah E. Cummings
Ranking Member
Committee on Oversight and
Government Reform
U.S. House of Representatives