Fact Sheet: Compromise To Fix Swaps Push-Out Rule Can Boost U.S. Economy And Improve Financial Stability

A proposed compromise on the treatment of financial derivatives amends a rule that threatens financial stability and imposes costs on the real economy.

This Compromise Has Bi-Partisan Support Through the Legislative Process

- **70 Democrats In The House Supported H.R. 992**: H.R. 992 passed the House of Representatives on October 30, 2013 by a vote of 292-122 with 70 Democrats supporting its passage.

- **22 Out Of 28 Democrats On HFSC Voted For H.R. 992**: H.R. 992, was reported out of the HFSC by a vote of 53-6 with 22 out of 28 Democrats supporting the measure.

- **Bipartisan Senate companion legislation (S. 474) authored by Sens. Hagan (D-NC), Pat Toomey (R-PA), Mark Warner (D-VA) and Mike Johanns (R-NE)**

The Original Swaps Push-Out Bill Was Well Intended, But Was Written At 2:30 AM And Actually Increases Systemic Risk

Fed's Scott Alvarez: He took aim at Dodd-Frank's so-called swaps pushout rule, which requires banks to spin off derivatives trading businesses that are in federally insured divisions. Fed officials have previously expressed concern about the requirements.

"You can tell that was written at 2:30 in the morning and so that needs to be I think revisited just to make sense of it," Alvarez said.

Politico, November 7, 2014

Former Fed Chairman Ben Bernanke: "716 requires the push-out of certain kinds of derivatives, which means the banks can't manage those derivatives, they have to be in a separate affiliate. And it's not evident why that makes the company as a whole safer. What we do see is that it will likely increase costs of people who use the derivatives and make it more difficult for the bank to compete with foreign competitors who can provide a more complete set of services. So there are some concerns about that particular rule."

This Refinement Has Strong Support of Banks of All Sizes, Who Are Concerned About the Ability to Serve Customers and Need a Timely Fix

From The WSJ: Regional banks are quietly joining the fight against one of the most hated Dodd-Frank provisions on Wall Street…The banks attending the meeting either declined to comment for the record or did not respond to a request for comment, except for Fifth Third, whose spokesman said the bank believes it provides a significant benefit to its "middle-market clients" by helping hedge against price fluctuations in the commodities they use and the final price they will receive for their products, a company spokesman said. "We provide these services as an accommodation, and our main concern is to do so cost-effectively from a customer perspective."

Among their concerns is that—unlike big banks—many smaller firms don't have existing affiliates outside the Federal Deposit Insurance Corp.-insured bank and aren't sure if it will be practical for them to form such affiliates, which will have to be separately capitalized, lobbyists say.

Wall Street Journal, October 30, 2104

This Bipartisan Fix Is A Compromise That Considers Extensive Derivatives Reforms

This bill is not a repeal of Lincoln Amendment, but a compromise that merely refines the provision, and considers that regulators (who have raised concerns with pushout) have made extensive reforms to significantly strengthen the current regulatory framework.

From Gary Gensler: "Regardless of what legal entity in a bank a swap is done, what we did in the cross border, very clearly, if it's a guaranteed affiliate or if it's in the bank, its covered. And I would say further, if it's in the bank… the bank, any branch around the globe, whether it's a branch in London or in Thailand, or Caymans or anywhere, its covered as a US person. So we actually have a little bit of a heightened standard if it's in the bank, because it's technically a US person, that means the reporting, the clearing, the trade execution, is all required." *CFTC Chairman Gary Gensler, Georgetown Law Bank Regulation Symposium, October 11, 2013*

What They're Saying

The Swaps Push-Out Provision Increases Systemic Risk

Rep. Carolyn Maloney: "I rise in support of H.R. 992. This bill passed overwhelmingly out of the Financial Services Committee earlier this year with broad bipartisan support with a vote of 53-6. The whole point of the Dodd-Frank reforms was to improve the safety and soundness of our financial system; and H.R. 992, the bill before us, will help us do just that. This bill does not expose the taxpayer to any additional risk. In fact, it includes a ban on taxpayer bailout of any swaps or any use of taxpayer money. Under H.R. 992, truly risky swaps will still be pushed out of commercial banks while at the same time bank regulators can see all of the bank's swaps activities. As well intended as section 716 is, it turns out it would actually hinder the oversight of regulators of the derivatives market." *Rep. Carolyn Maloney, October 30, 2013*

Rep. Gary Ackerman: "My opposition to the Senate-added swaps "push-out" provision, Section 716, was based solely on the fact that it was wholly at odds with two central tenets of the Dodd-Frank Act, reducing systemic risk and increasing derivative market-transparency…The "push-out" provision would have forced dealer banks to push their swaps businesses out of their heavily regulated and capitalized insured depository institutions and into a less-regulated affiliate, or even worse, outside of the U.S. regulatory-jurisdiction and therefore outside of federal jurisdiction altogether." *Rep. Gary Ackerman, December 6, 2011*

New Democrats: "We agree with leading regulators and Administration officials, including former Chairman Volcker and current Federal Reserve Chairman Ben S. Bernanke, Treasury Secretary Timothy F. Geithner, SEC Chairwoman Mary L. Schapiro and FDIC Chairwoman Sheila C. Bair, who have all expressed opposition to Senate Section 716 – also known as the "swaps desk spinoff" – that would increase systemic risk by forcing derivatives transactions into less regulated and less capitalized institutions and impede effective regulatory oversight of the derivatives markets. Legitimate conflict of interest concerns are addressed by the ban on proprietary trading in the Volcker Rule, and, accordingly, we believe Section 716 should be removed from the legislation." *New Democrat Coalition letter to the House Financial Services and Senate Banking Committees, June 16, 2010*

The Bipartisan Policy Center: "Two late additions to Congress's response to the financial crisis have proved to be among the most complex and challenging for U.S. financial regulators to put into place. The degree of difficulty these two rules present, their unknown impact on financial markets and the economy, and the lack of international coordination surrounding them have led to continued regulatory delay with promulgating these two rules.

Accordingly, the Capital Markets Task Force of the Bipartisan Policy Center's (BPC) Financial Regulatory Reform Initiative recommends an improved alternative solution to the proposed Volcker Rule on proprietary trading and the Lincoln Amendment on "pushing-out" dealing on swaps. The task force recommends a different approach to facilitate the implementation of the Volcker Rule and also recommends delaying implementation of the Lincoln Amendment on swaps push-out until more real-world experience is gained with the Volcker Rule, however it is adopted." *A Better Path Forward on the Volcker Rule and the Lincoln Amendment, October 23, 2013*

The Swaps Provision Is Unnecessary

Paul Volcker: "The provision of derivatives by commercial banks to their customers in the usual course of a banking relationship should not be prohibited…My sense is that the understandable concerns about commercial bank trading in derivatives are reasonably dealt with in Section 619…" *Former Federal Reserve Chairman Paul Volcker in letter to Sen. Chris Dodd, May 6, 2010*

Section 716 Weakens Financial Stability And Gives Foreign Banks A Competitive Advantage

Former Fed Chair Ben Bernanke: "…section 716 would essentially prohibit all insured depository institutions from acting as a swap dealer or a major swap participant–even when the institution acts in these capacities to serve the commercial and hedging needs of its customers or to hedge the institution's own financial risks. Forcing these activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities."

"Depository institutions use derivatives to help mitigate the risks of their normal banking activities. Use of derivatives by depository institutions to mitigate risks in the banking business also provides important protection to the deposit insurance fund and taxpayers as well as to the financial system more broadly. Thus, banks are well situated to be efficient and prudent providers of these risk management tools to customers."

"…foreign jurisdictions are highly unlikely to push derivatives business out of their banks. Accordingly, foreign banks will have a competitive advantage over U.S. banking firms in the global derivatives marketplace, and derivatives transactions could migrate outside the United States." *Federal Reserve Chairman Ben Bernanke in letter to Sens. Chris Dodd, Richard Shelby, and Kirsten Gillibrand, May 13, 2010*

Mark Zandi Worries Section 716 Reduces Resolvability, Which Risks Taxpayer Money

Moody's Chief Economist Mark Zandi: "One of the primary objectives of the financial reforms enacted after the 2008 failures was to provide for a way to resolve large financial firms should a similar crisis develop in the future. The resolution authority section of the law was crafted to do so, but Section 716 works against that goal. It does so because it causes firms to segment the derivatives with individual counterparties and requires that another entity be created to engage in the pushed-out transactions. Creating new operations, and expending additional capital to make them robust enough, is in contrast to the resolution planning objectives of eliminating entities and simplifying structures."

Mark Zandi Letter to Rep. Scott Garrett, November 14, 2011

Hedging tools for commodities, equities and non-securitized products are important to U.S. Businesses and the U.S. Economy, Adding $150 Billion Dollars In Economic Activity From 2003 To 2012 And More Than Half A Million Jobs

U.S. Chamber of Commerce: "The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of every size, sector, and region, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, strongly supports H.R. 992, the "Swaps Regulatory Improvement Act," which would serve to promote vibrant and efficient capital markets by modifying section 716 of the Dodd-Frank Act, a provision that undermines the Act's central policy objective of mitigating systemic risk." *U.S. Chamber of Commerce, October 29, 2013*

Milken Institute: This study charts the benefits to the wider economy from the use of financial derivatives and is a first-of-its-kind examination of derivatives' quantitative impact on economic growth. It charts the positive effects in the U.S. economy from their use, both in the financial and non-financial sectors.

- Banks' use of derivatives, by permitting greater extension of credit to the private sector, combined with the use of derivatives by non-financial firms, expanded U.S. real GDP for about $3.7 billion each quarter from 2003 to 2012.
- The total increase in economic activity was 1.1 percent ($149.5 billion) between 2003 and 2012.
- By the end of 2012, employment had been boosted in these years by 530,400 (0.6 percent) and industrial production 2.1 percent, due to the use of derivatives.