Testimony of

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On Behalf Of The

Institute of International Bankers

Before the

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"Proposals to Amend Title VII of the Dodd-Frank Act"

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Chairman Garrett, Ranking Member Waters and members of the Subcommittee.

My name is Keith Bailey. I am a Managing Director in the Fixed Income, Currencies and Commodities Division of Barclays Capital where I have responsibilities in e-commerce and for evaluating and implementing the changes to our derivative businesses globally resulting from enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). I have over twenty five years of experience in the derivatives market both here in the U.S. and abroad. I am very pleased to be here today to testify on behalf of the Institute of International Bankers (IIB) regarding H.R. 1838, H.R. 2586, H.R. 2779 and H.R. 3045. Many of the issues sought to be addressed by these bills are very important to the IIB membership. The IIB represents internationally headquartered financial institutions from over 35 countries around the world; its members include international banks that operate branches and agencies, bank subsidiaries and broker-dealer subsidiaries in the United States. International banks provide an important source of credit for U.S. borrowers and enhance the depth and liquidity of U.S. financial markets. Their U.S. operations contribute billions of dollars each year to the economies of major cities across the country through the employment of over 250,000 U.S. citizens and permanent residents and through other operating and capital expenditures.

At the outset, let me say that the IIB and its members support Dodd-Frank's objectives of reducing systemic risk and increasing transparency in the financial markets. Many IIB members' home country jurisdictions are also working to supplement their existing regimes to incorporate derivatives clearing and market transparency reforms to achieve regulatory objectives similar to those in Dodd-Frank and to support the commitments of the G-20 leaders to setting high, internationally consistent requirements for OTC derivatives. In addition, even before Dodd-Frank was enacted, many of those jurisdictions already regulated swap dealers under their existing regimes for the regulation of market professionals.

It is also important to note that foreign banks and U.S. banks alike seek to minimize the number of legal entities through which they conduct swap dealing activities, and where possible, to use a single legal entity to transact with swap counterparties globally. This increases efficiency and decreases risk by permitting the bank and its counterparties to net and offset their exposures. It also allows counterparties to transact with a more creditworthy entity, which for foreign banks is usually located and supervised outside of the U.S. The personnel who have relationships with U.S. customers or manage U.S.-related portfolios on behalf of their head office are often, however, located inside the U.S.

The IIB has been particularly active in developing a proposal that we hope will assist global regulators to develop a workable regime for supervising U.S. and foreign firms that operate global swap businesses. This proposal recognizes that these firms structure their swap businesses in various ways and has been carefully crafted to ensure that, where these businesses (however structured) involve transacting with customers in the United States, U.S. customers are protected by dealing with a U.S.-registered swap dealer that is responsible for compliance with U.S. clearing, trading, reporting and business conduct standards. Recognizing the resource constraints of U.S. regulators, our proposal suggests that U.S. regulators should leverage effective foreign supervision while still retaining their full enforcement authority. Thus, if U.S. regulators determine that home country capital and other entity-wide regulations are sufficiently comparable to U.S. regulations, then, under our proposal, compliance with those regulations would constitute compliance with U.S. requirements, and failure to comply would be treated as noncompliance with U.S. requirements, enforceable by U.S. regulators.

While I would like to focus my testimony on H.R. 1838 and 2779, it is important that we not lose sight that, as the swaps market is a global one, it is imperative that the laws of the many jurisdictions in which global swap dealers operate be harmonized to the greatest extent possible. For example, OTC derivatives trade in a global market and market participants can currently execute in venues that operate in multiple jurisdictions. Accordingly, U.S. regulators should seek to harmonize their rules on swap execution facilities (SEFs) with analogous rules in other major jurisdictions, since material differences would likely fragment liquidity into separate, locally regulated venues. In particular, U.S. rules on pre-trade transparency should not be structured in such a manner so as to discourage foreign market participants from trading on U.S. SEFs or effectively to preclude organized trading facilities in other jurisdictions from being eligible to execute trades for U.S. market participants. We believe that H.R. 2586's clarifications would help to achieve these objectives.

In addition, the IIB supports the clarifications proposed to be made in H.R. 3045 as it clarifies that foreign plans will not be considered Special Entities. We also urge that consideration be given to clarifying that other foreign entities, such as endowments, will not be treated as Special Entities.

H.R. 1838

This bill, sponsored by Representative Hayworth, would repeal Section 716 of Dodd-Frank, also known as the swaps "push-out" provision. Our principal concern with Section 716 is its impact on uninsured U.S. branches and agencies of foreign banks. Many foreign banks operate uninsured branches and agencies in the U.S. In the aggregate, these branches and agencies have more than $2 trillion in assets. In addition to lending and engaging in certain securities, asset management and other similar activities, many such branches and agencies also engage in swap dealing. Dodd-Frank provides that branches and agencies engaged in swap dealing activity be required to register with the Commodity Futures Trading Commission (CFTC) and/or the Securities and Exchange Commission (SEC) with respect to their swap dealing activity. Accordingly, they will be "swap entities" under Section 716.

Section 716 generally provides that no "Federal assistance" may be provided to any swaps entity with respect to any swap, security-based swap or other activity of the swap entity. "Federal assistance" is defined to include advances from the discount window and FDIC insurance. Uninsured U.S. branches and agencies of foreign banks are licensed by a federal or state banking authority, they are subject to the same type of safety and soundness examination and oversight as U.S. banks, and, like U.S. banks, they are eligible to borrow from the Federal Reserve discount window so long as the advance is secured by high quality collateral and subject to discount.[1] From the Federal Reserve's perspective, maintaining U.S. branches' and agencies' access to the discount window is an important tool for maintaining a sound and orderly financial system.

The general prohibition under Section 716 relating to Federal assistance applies to both U.S. FDIC-insured banks and uninsured U.S. branches and agencies of foreign banks that are swap entities. The general prohibition is, however, subject to several important exclusions, grandfathering provisions and transition periods, but these provisions apply only to "insured depository institutions" (IDIs). As a result, uninsured U.S. branches and agencies would appear not to be eligible for the exclusions, grandfathering and transition provisions applicable to IDIs.

When Section 716 was enacted, members of Congress acknowledged that this differential treatment of uninsured U.S. branches and agencies of foreign banks was "clearly unintended" and recognized the need "to ensure that uninsured U.S. branches and agencies of foreign banks are treated the same as insured depository institutions," consistent with the U.S. policy of national treatment.[2] However, as was explained at the time, in the rush to complete the conference and finalize Section 716 there was no opportunity to rectify this "significant oversight."[3]

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[1] See Federal Reserve Regulation A, 12 C.F.R. § 201.1 (extending rules relating to eligibility for Federal Reserve Bank lending to "United States branches and agencies of foreign banks").

[2] 156 Cong. Rec. S5903-S5904 (daily ed. July 15, 2010) (colloquy between Senator Dodd and Senator Lincoln).

[3] Id.

As a result, the exclusion in Section 716(d) that permits IDIs to continue to engage in certain traditional swap dealing activities, including dealing in interest rate and foreign currency swaps, and to use swaps for hedging and other similar risk-mitigating activities, would appear not to be available to uninsured U.S. branches and agencies of foreign banks. If uninsured branches and agencies that are swap entities were ineligible for this exclusion, then their U.S. customers would lose the benefit of trading with them. These customers would have to establish new trading relationships away from the U.S. branch or agency in order to engage in traditional swap transactions, as well as those swap activities that are not covered by the Section 716's exceptions. This would significantly reduce competition and worsen pricing in the U.S. swaps market, especially given that 8 of the 14 largest global derivatives dealers are foreign banks.

In addition, the resulting differential treatment relative to U.S. FDIC-insured banks would overtly discriminate against and competitively disadvantage foreign banks. This represents a significant departure from the long-standing U.S. policy that U.S. branches and agencies of foreign banks are subject to the same rules, regulations and oversight, i.e., national treatment, as U.S. banks. Finally, it would provide precedent for foreign jurisdictions to provide advantages to their local banks at the expense of the foreign operations of U.S. banks, if not in the context of swaps then potentially in other contexts.

Section 716(b)(2)(B) also excludes from the scope of Section 716 an IDI that is a major swap participant or major security-based swap participant. This exclusion is important to those IIB members that may be deemed to be major swap or security-based swap participants. The definition of major swap participant encompasses not only persons engaged in ongoing swap activities but also potentially persons with only legacy positions. Thus, if uninsured branches and agencies were not treated as IDIs for this purpose, then they could be subject to Section 716 as a result of legacy positions in a way that a U.S. FDIC-insured bank would not.

Finally, Section 716(e) provides that Section 716's prohibition on Federal assistance "shall only apply to swaps or security-based swaps entered into by an insured depository institution after the end of [Section 716's] transition period." Therefore, the existing swaps of IDIs are grandfathered from Section 716. Relatedly, Section 716(f) gives an IDI's appropriate Federal banking agency the authority to grant the institution a transition period of up to three additional years beyond Section 716's July 16, 2013 effective date before the institution must divest or cease its swap activities. The purpose of this transition period is to prevent the restructurings necessary to comply with Section 716 from adversely disrupting the institution's lending and other non-swaps activities.

The implications of these issues are potentially serious. The less than two years remaining before uninsured U.S. branches and agencies that are swap entities must "push out" all their existing swap positions and ongoing swaps activities is precious little time, particularly relative to the longer period—close to five years—before IDIs will have to make their transition. Moreover, the absence of any grandfathering of existing positions would mean that the transition for foreign banks and their counterparties would be much more disruptive, more similar to an insolvency in many respects than to an orderly business restructuring:

- Swap dealing is typically conducted as an integrated part of a bank's overall business. Swap positions often hedge loan and other non-swap positions, and risk management and other systems are often shared across many different types of trading activities, not just those involving swaps. Winding down or restructuring swap dealing activities will as a result have significant spill-over effects on non-swaps businesses, with material impacts on the overall U.S. economy, given that the U.S. branches and agencies of foreign banks provide 18 percent of all commercial and industrial loans made by banks in the U.S.

- A significant number of customers have master agreements directly with the uninsured U.S. branches and agencies of foreign banks, or have multi-branch netting agreements to which one or more uninsured U.S. branches or agencies are parties. The assignment, novation or modification of these agreements, even to an affiliate, almost always requires counterparty consent and will in many cases require renegotiation of existing terms and conditions.

- Counterparties may even refuse assignment or novation, for example, due to the inability to net and setoff collateral and payment obligations, thereby triggering litigation over exercise of “illegality” and similar provisions in those agreements.

- Renegotiation and litigation will lead to delays in trading, resulting in diminished liquidity and higher spreads and costs to participants and counterparties.

- Assignment or novation of existing positions will likely have significant tax consequences both for the foreign bank and its counterparties.

- Assignment or novation could also potentially trigger other requirements under Dodd-Frank, such as mandatory clearing and trading requirements.

- There are significant capital and technology costs associated with capitalizing a U.S. subsidiary to engage in traditional swap activities and using a new booking structure. Additionally, the modification of existing systems to track new booking structures will put a very heavy strain on information technology resources that are already overwhelmed with the other changes necessary because of Dodd-Frank.

In repealing Section 716, H.R. 1838 effectively accords equal treatment to foreign banks, aligning with longstanding U.S. national policy, and eliminates the significant negative impacts on capital, netting and risk management that would result from conducting derivative trading through multiple U.S. legal entities. For this reason, the IIB strongly supports H.R. 1838.

H.R. 2779

The IIB and others have taken the position that swap transactions between affiliates should not trigger certain Title VII requirements, including registration, margin, clearing and exchange/SEF-trading.[4] Inter-affiliate swaps serve several purposes. From the client end-user perspective, inter-affiliate swaps provide them with the ability to enter into derivatives transactions with firms that have the requisite expertise in a given swap product or a presence in a particular geographic market while, at the same time, minimizing the number of legal entities with which they transact by permitting the firm to manage the market risk of the transaction in a different entity than the one transacting with the client. Inter-affiliate transactions also provide end-users with the ability to net their exposures and margin calls, as well as reduce the amount of collateral that must be posted. Global swap dealers use inter-affiliate swaps to most effectively hedge risks associated with particular swap transactions and, at the same time, centrally and more efficiently manage its overall risk.

Congress intended that Title VII's requirements apply to swap transactions with third parties.[5] Inter-affiliate swaps neither raise additional counterparty exposure nor increase interconnectedness between market participants. As both the CFTC and the SEC have acknowledged, inter-affiliate transactions are, in most cases, entered into to allocate risk within a corporate group, not to supply liquidity to, or accommodate the independent trading objectives

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[4] See Financial Trade Association Letter on Treatment of Inter-Affiliate Transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, dated September 8, 2011.

[5] Senator Blanche Lincoln stated, "it would be appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between for [sic] wholly owned affiliates of a financial entity." 156 Cong. Rec. S5921, July 15, 2010. Senator Susan Collins also noted that it was not Congress's intent to "capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates." 156 Cong. Rec. S5907, July 15, 2010. Senate Banking Committee Chairman Chris Dodd agreed with Senator Collin's assessment of the law. Id.

of, a third party. In fact, requiring inter-affiliate swaps to comply with many of the Title VII requirements could actually increase risk for individual swap dealers, as well as for the broader market, by impeding internal risk management and mandating strict adherence to costly and burdensome regulatory requirements that provide little to no benefits.

As discussed above, our proposal for swap dealer regulation and supervision contemplates that U.S. affiliates of foreign banking organizations will enter cross-border inter-affiliate transactions. To subject these cross-border transactions to U.S. swap requirements could expose global swap dealers to multiple and possibly conflicting regulatory requirements. Most importantly, applying swap rules to inter-affiliate transactions could have the unintended and counterproductive effect of lessening market transparency, increasing costs generally, and increasing risk both within individual institutions as well as to the overall market.

The IIB supports H.R. 2779, co-sponsored by Representatives Stivers and Fudge, as it addresses many of our concerns and makes clear that Title VII's requirements do not apply to inter-affiliate swap transactions. Prudential regulators would continue, through their supervisory role, to have oversight of these transactions and to impose capital and other requirements as appropriate, both at the holding company and subsidiary levels. The CFTC and SEC, as market regulators, would, under H.R. 2779, continue to have access to inter-affiliate transaction data as reported to either regulated swap data repositories or the CFTC or SEC as appropriate. To the extent that the Commissions uncover specific evasive conduct involving inter-affiliate transactions, they would retain their authority to address that conduct. We believe that H.R. 2779 strikes the right balance by ensuring that the prudential supervisors and the market regulators have the requisite tools with which to perform their regulatory responsibilities and, at the same time, ensuring that Dodd-Frank objectives of reducing systemic risk and increasing transparency are not undermined.

Conclusion

Thank you for the opportunity to testify today on behalf of the IIB. We appreciate your attention to these important issues under Title VII of Dodd-Frank, and encourage you to continue to work with the CFTC, the SEC and the prudential regulators to assure that Title VII is implemented in a way that establishes a level playing field, makes efficient use of U.S. and foreign supervisory resources and promotes international harmonization.

United States House of Representatives
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Keith Bailey	Institute of International Bankers
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature: Keith Bailey	

Please attach a copy of this form to your written testimony.