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April 12, 2010

The Honorable Harry Reid
522 Hart Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Mitch McConnell
361-A Russell Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Christopher Dodd
448 Russell Building
United States Senate
Washington, DC 20510

The Honorable Richard Shelby
304 Russell Senate Office Building
United States Senate
Washington, DC 20510

Dear Senators Reid, McConnell, Dodd, and Shelby:

The ABA Securities Association (ABASA)[1] wishes to bring to your attention a provision in Title VI of the Committee Print entitled "The Restoring American Financial Stability Act of 2010" that would both impair banking organizations' ability to manage risks within their organizations and increase the interconnectedness of banking institutions with other financial institutions and third party market participants. Rather than reducing risk in our financial system, this provision would have the unintended consequence of significantly increasing counterparty credit risk.

Section 608 of the Committee Print would add derivative transactions to the list of inter-affiliate transactions subject to the quantitative limits of Section 23A of the Federal Reserve Act. As a result, these derivative transactions, designed to hedge risk within the holding company on an enterprise-wide basis, would effectively be pushed out of the holding company and would have to be conducted instead with third parties—ironically increasing the very global interconnectedness of institutions that legislators and regulators are seeking to curtail through this reform legislation.

The need for Section 608 would be understandable if inter-affiliate derivatives transactions contributed to the economic crisis. However, it is widely recognized that such transactions did not cause or exacerbate the financial crisis. Indeed, as the Federal Reserve Board has recognized, inter-affiliate derivative transactions serve a valuable and efficient enterprise-wide risk mitigation function. Consequently, this provision thwarts a second goal of regulatory reform legislation, namely to develop efficient and effective risk management infrastructures at all financial institutions.

Moreover, no consideration has been given to how this provision, applicable only to US banking organizations, could competitively disadvantage domestic institutions and their customers. The loss of intragroup, inter-affiliate risk management efficiencies will clearly create costs for US

[1] ABASA is a separately chartered trade association representing those holding company members of the American Bankers Association (ABA) actively engaged in capital markets, investment banking, and broker-dealer activities.

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banks that non-US competitors will not have to bear. In addition, non-US banks will continue to be able to offer integrated solutions to customers through a primary customer-facing entity. In contrast, US banks will need to propose that customers do business with multiple parties—an inefficiency that customers would be highly unlikely to tolerate.

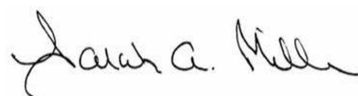
Most importantly, the provision ignores the fact that the Federal Reserve Board studied this question extensively over several years in the early 2000s and determined that there were significant benefits from allowing the inter-affiliate risk management structure to continue to operate, subject to compliance with the arm's length market terms requirements of Federal Reserve Act Section 23B. In this way, the FRB determined, U.S. banks could be both protected and competitive.

We recognize that the Committee Print is an improvement over the original administration proposal and the earlier discussion draft, particularly as it recognizes the importance of netting agreements and collateralization in reducing derivative exposure. Nevertheless, ABASA is concerned that should this provision be enacted into law, the unintended consequences would be both negative and significant. No hearings or other public record have been established to determine why this language is needed or the impact such change could have on banks' ability to manage risk efficiently. Of particular concern to ABASA's membership is the fact that the quantitative limits of Section 23A would be placed on transactions that cause "a member bank or subsidiary to have a credit exposure to the affiliate" without defining the term "credit exposure." Although our clearly preferred course is to eliminate those provisions of Section 608 aimed at covering derivatives with Section 23A restrictions, ABASA members believe that, at a minimum, this proposal should not be adopted without additional clarification that "credit exposure" from inter-affiliate derivative transactions is to be quantified using the same generally accepted mark-to-market valuation methodologies that are applied to an institution's arm's-length derivative transactions with third parties.

For all of these reasons, ABASA believes that those provisions of Section 608 aimed at derivatives transactions should be eliminated from the Committee Print.

Thank you for considering ABASA's views on this important issue.

Sincerely,



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