American Bankers Association.

# Backgrounder

**ABA Media Contact:**
Jeff Sigmund
jsigmund@aba.com, 202-663-5439

December 2014

## ABA Backgrounder: Swaps Push-Out Provision

Section 716 of the Dodd-Frank Act, also known as the "Swaps Push-Out Rule," would have required FDIC-insured banks that are registered swap dealers to spin off certain derivatives transactions - namely certain commodity, equity swaps and uncleared credit default swaps - into separate non-FDIC insured units. That means that even if Section 716 was implemented as originally passed, it would still have been permissible for an FDIC-insured bank to maintain a portfolio containing the two most actively-traded asset classes, i.e., interest rate and foreign exchange swaps.

According to the Office of the Comptroller's Bank Activities and Trading Report for the Second Quarter of 2014, interest rate and foreign exchange derivative products accounted for 94 percent of the total derivative notional amounts by insured U.S. commercial banks and saving associations.

The amendment to the Swaps Push-Out Rule does not repeal Section 716; it narrows the scope of products that are required to be "pushed-out" of an FDIC-insured bank to certain swaps related to structured finance.

**Right Move for Bank Customers and the Broader Economy**
The majority of banks that use swaps do so to hedge or mitigate risk from their ordinary business activities, including lending. The swaps push-out requirement to move some swaps into separate affiliates previously made one-stop shopping impossible for businesses ranging from family farms to energy companies that want to hedge against commodity price changes.

Lawmakers in both parties and financial regulators tasked with writing regulations to interpret the law have long acknowledged that Section 716 is flawed for several reasons.

- **Higher Prices.** Without the amendment, customers who hedge certain commodity risk - such as the cost of fuel, manufacturing inputs like copper and breakfast cereal inputs like corn and wheat - by entering into commodity swaps were likely to face higher prices because a non-bank unit would be unable to offer the same price as the bank.
- **Decreased Competition.** Some banks that don't have existing affiliates outside their FDIC-insured bank would have found it to be impracticable to form affiliates for purposes of complying with the swaps push-out rule and would have stopped offering these swaps. This would have decreased competition among banks for these transactions, which may have resulted in less favorable pricing to the customer.
- **Increased Systemic Risk.** While supporters of the law assert that it would decrease systemic risk, many policymakers, including former Federal Reserve Chairman Ben Bernanke, recognized that the law could do precisely the opposite by moving the relevant derivatives activity into units that are less-regulated and subject to less oversight than banks.

**Amending Rule had Broad Bipartisan Support**
The amendment to the swaps push-out rule had broad bipartisan support and was subject to debate in Congress. The exact language found in the omnibus bill was first introduced in the House of Representatives as H.R. 992 in 2013 and a companion bill, S. 474, that was introduced on a bipartisan basis in the Senate. H.R. 992 was reported out of the House Financial Services Committee by a vote of

53-6 with 22 out of 28 Democrats supporting the measure. The House of Representatives passed H.R. 992 by a vote of 292-122 with 70 Democrats supporting the bill.

**Swaps Remain Subject to Strong Regulation**

Following the 2008 financial crisis, the U.S. Treasury published a white paper outlining the steps it intended to take to reform the financial system, including a number of steps to reform the swaps market.

The four steps for reforming the swaps market are:

- Preventing activities in those markets from posing risk to the financial system
- Promoting the efficiency and transparency of those markets
- Preventing market manipulation, fraud and other market abuses; and
- Ensuring that OTC are not marketed inappropriately to unsophisticated parties.

Policymakers did not identify "pushing out" swaps from FDIC-insured banks as a relevant part of their swaps reform agenda.

Pursuant to Title VII of the Dodd-Frank Act, a robust regulatory framework has been established by the Commodity Futures Trading Commission to regulate a significant portion of the swaps market. This framework includes registration, business conduct, clearing, trade execution, reporting, and recordkeeping requirements. The CFTC's rule writing is nearly complete and all the steps discussed in the white paper are well on their way to being realized.

*The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.*

# # #