Congress of the United States
Washington, D.C. 20515

July 31, 2019

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

The Honorable Joseph Otting
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219

Dear Chairman Powell, Chairman McWilliams, and Comptroller Otting:

We write to express our strong opposition to any weakening of the initial margin requirements for swaps transactions between insured depository institutions (IDIs) and their affiliates because it would harm financial stability and U.S. taxpayers.

As you know, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act in the wake of the 2008 financial crisis to ensure that banks would no longer be able to gamble on risky derivatives, like swaps, and expect to get bailed out by the government when they lost those bets. In order to reduce risk, increase transparency and promote market integrity, Title VII of Dodd-Frank established a new regulatory framework for the previously opaque over-the-counter (OTC) derivatives market. Under the law, swaps transactions generally require collateral in the form of margin and capital to ensure that counterparties can honor their commitments. Such collateral protects taxpayer-insured banks from gambling by their affiliates operating in the capital markets, as well as by their foreign affiliates that can avoid U.S. regulation.

Initial margin for swaps between taxpayer-backed banks and their affiliates is not just collateral that the banks would otherwise be able to use. Instead, margin requirements are the primary means of addressing risks from affiliates that may be transferred back to the banks. For that reason, the Federal Reserve Board (Fed), Office of the Comptroller of Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Farm Credit Administration, and Federal Housing Finance Agency explicitly required banks to collect margin when transacting with their affiliates, which may be located overseas.[1]

According to former FDIC Vice Chairman Thomas Hoenig, "[i]nter-affiliate margin ensures there is sufficient capital and liquidity to the financial firm and the market, should any unit of a consolidated

[1] Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74,840 (Nov. 30, 2015), https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf

banking company find itself in a position where it cannot serve end-users, or where its failure becomes a threat to the broader economy and the taxpayer."[2] Vice Chairman Hoenig pointed out that affiliates are incentivized to transfer their risk though uncleared swaps to U.S. banks who have valuable subsidies, including the implicit presumption that they will be bailed out. If the banks do not collect margin from their affiliates on these trades, the banks effectively take on their affiliates' risks, which then become subsidized by the taxpayer. Vice Chairman Hoenig also noted that, "requiring JP Morgan's affiliate operating in London to post margin to JP Morgan's US Bank, would have helped keep the [$2 billion] London Whale trading losses outside of the federally-insured bank."

Moreover, regulators explicitly rejected any argument that transactions among banking affiliates should be exempted from inter-affiliate margin because it is unnecessary and may discourage effective risk-management. As Daniel Tarullo, a former governor at the Fed, noted in 2015, requiring initial margin for these transactions "will protect the safety and soundness" of the banks and "will make the resulting risks transparent to both parties and will incentivize strong risk management."[3] The final margin rule passed by prudential regulators stated that it was necessary to maintain initial margin postings for transactions with prudentially regulated affiliates because otherwise such transactions could "pose a risk to systemic stability."[4]

Developments abroad also caution against any further weakening of inter-affiliate margin requirements. We are particularly concerned about offshore risks affecting U.S. affiliates in light of the U.K.'s decision to leave the European Union, known as Brexit, which is set to take place later this year. This action could not only lead to market instability, but also a race-to-the-bottom approach to financial regulation generally between the U.K. and E.U. Indeed, the head of the Financial Conduct Authority in the U.K. has already stated that he would favor a "lower burden" approach to financial regulation.[5]

Troublingly, U.S. regulators have also sought to lower regulatory safeguards, including capital requirements for the largest Wall Street banks. In particular, the Fed and OCC last year proposed to "tailor" the enhanced supplementary leverage ratio for globally systemically important holding companies, which, by their own analysis, would reduce the amount of capital held by taxpayer-backed insured depository institutions by approximately $121 billion.[6]

These actions, here and abroad, will result in a reduced amount of funds held by U.S. banks and their foreign affiliates to safeguard taxpayers from another financial crisis where they, not the banks, will be left to foot the bill. Expanding the inter-affiliate swap exemption to all transactions would drain even more resources from insured depository institutions and increase the risk of a future taxpayer bailout still further.

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[2] Letter from FDIC Vice Chairman Hoenig to Chairman Rodger and Ranking Member Lowey of the House Committee on Appropriations (July 16, 2015), *available at* https://www.fdic.gov/about/learn/board/hoenig/hoenigletter6-16-15.pdf.

[3] Letter from Daniel Tarullo to the Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/aboutthefed/boardmeetings/swap-margin-board-memo-20151030.pdf.

[4] 80 Fed. Reg. 74,889.

[5] Cat Rutter Pooley, *FCA Chief Eyes "Lower Burden" Regulation After Brexit*, Financial Times (Apr. 23, 2019), *available at* https://www.ft.com/content/62097db4-65c1-11e9-9adc-98bf1d35a056.

[6] Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies, 83 Fed. Reg. 76 (Apr. 19, 2018).

Finally, banks have seen record profits and do not appear to be economically constrained by current margin requirements. There are eight U.S. banks that have been designated as global systemically important banks (G-SIBs) that hold a combined $11.1 trillion in assets, comprising roughly 50 percent of domestic banking assets.[7] In 2018 alone, the six largest U.S. banks made more than $111 billion in profits.[8] Over the last 10 years, U.S. G-SIBs made $780 billion in profits.

For all of these reasons, we urge you to maintain the current requirements to post initial margin for any swaps transaction with a prudentially regulated affiliate of a U.S. banking entity. Any decision to reduce such requirements is a deliberate decision for less stability in the financial system.

Sincerely,

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services

The Honorable Sherrod Brown
Ranking Member
Senate Banking Committee

[7] For a list of the largest bank holding companies, *see* https://www.ffiec.gov/nicpubweb/nicweb/hcsgreaterthan10b.aspx.; *see also* U.S. Department of The Treasury, "A Financial System That Creates Economic Opportunities- Banks and Credit Unions" (Jun. 2017), https://www.treasury.gov/press-center/press-releases/documents/a%20financial%20system.pdf.

[8] L.A. Times, *The nation's largest banks enjoyed $111 billion in record profits last year- with more to come* (Jan. 16, 2019), https://www.latimes.com/business/la-fi-bank-record-profits-20190116-story.html. The industry as a whole made a record $236.7 billion in profits in 2018, which is an increase of 44 percent from 2017. *See* Federal Deposit Insurance Corporation, *FDIC Quarterly Banking Profile* (Feb. 21, 2019), https://www.fdic.gov/bank/analytical/qbp/2018dec/https://www.fdic.gov/bank/analytical/qbp/2018dec/.