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Ranking Member, Committee on Oversight and Government Reform
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February 26, 2015

Dear Senator Warren and Representative Cummings:

I write in response to your letter dated January 29, 2015 regarding JPMorgan Chase Bank, N.A. ("JPMCB") and Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), as amended by Section 630 of the 2015 Consolidated and Further Continuing Appropriations Act of 2015 (the "Appropriations Act").

Section 630 of the Appropriations Act modifies Section 716 of the Dodd-Frank Act by excluding non-structured finance swap transactions from those required to be pushed out of banks, while maintaining the prohibition on the use of taxpayer funds for insolvent or potentially insolvent bank swap dealers where such condition is due to its swap activity.[1] Section 630 permits banks to continue to help customers manage their credit, interest rate, foreign exchange and other risks through non-structured finance swap products, as well as use derivatives to hedge their own risks. This modification is consistent with the serious concerns expressed during the consideration of Section 716 by the heads of all three federal banking agencies at the time,[2] as well as former Federal Reserve Chairman Paul Volcker.[3] Former Federal Reserve Chairman Ben Bernanke stated that Section 716 would "weaken

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[1] Section 716(i) of the Dodd-Frank Act (precluding the use of taxpayer funds to prevent the receivership resulting from swap activity of any swap entity that is FDIC-insured or that has been designated systemically significant, requiring that swap activity of any such entity that is in receivership or declared insolvent due to swap activity be subject to termination or transfer and requiring that all funds expended on the termination or transfer of swap activity of such a swap entity be recovered, either through the disposition of assets of the swap entity or by assessments, including on the financial sector.)

[2] Letter from Ben Bernanke, Federal Reserve Chairman, to Senator Christopher Dodd (May 13, 2010), *available at* http://blogs.wsj.com/economics/2010/05/13/bernanke-letter-to-lawmakers-on-swaps-spin-off (hereinafter "Bernanke Letter"); Letter from Sheila Bair, FDIC Chairman, to Senators Christopher Dodd and Blanche Lincoln (Apr. 30, 2010), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2010-05-04/pdf/CREC-2010-05-04-pt1-PgS3065-2.pdf#page=5 (hereinafter "Bair Letter"); and Remarks by John Dugan, Comptroller of the Currency, at the Thomson Reuters Global Financial Regulation Summit 2010 (Apr. 27, 2010).

[3] Letter from Paul Volcker, former Federal Reserve Chairman, to Senator Christopher Dodd (May 6, 2010), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2010-05-12/pdf/CREC-2010-05-12-pt1-PgS3569-9.pdf#page=40.

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financial stability and strong prudential regulation of derivatives activities,"[4] and former FDIC Chairman Sheila Bair said in a letter to former Senate Banking Committee Chairman Chris Dodd and former Agriculture Committee Chairman Blanche Lincoln that "one unintended outcome of [Section 716] would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund . . ."[5] Concerns with Section 716 persisted post-Dodd-Frank, with then-Chairman Bernanke stating that he still shared the view that it was a good idea to repeal parts of the swap push-out rule, that "[t]he Federal Reserve had concerns about this prior to the enactment of the law, and we still have concerns about it."[6]

It should be noted that the comprehensive regulation of over-the-counter ("OTC") derivatives, as proposed by the G20 and Treasury after the financial crisis and as implemented by Title VII of the Dodd-Frank Act, is not affected by this modification. The OTC derivatives regulatory reforms have mitigated risks to the financial system, increased transparency and provided enhanced customer protections. The key provisions of Title VII – mandatory clearing, margin for uncleared derivatives, trade reporting, business conduct and swap execution facility trading – all remain in place. Perhaps more significantly, trading assets are subject to (i) dramatically higher risk-based capital requirements than pre-crisis, (ii) a new regime of liquidity requirements and (iii) a supplementary leverage limit that is 100 basis points higher if the assets are held at a bank rather than a non-bank affiliate.

If JPMCB had been required to implement Section 716 absent the changes in Section 630, both JPMCB and its customers would have faced increased credit and operational risks. The current centralized booking of swaps in the bank and its various branches, which allows for netting of exposures within a single, global entity, would have been replaced with bifurcated swap portfolios between JPMCB and its push-out affiliates. This bifurcation would have resulted in a loss of netting for JPMCB and its customers, with resulting increased credit risk on both sides. JPMCB would have faced increased operational risk from several sources as a result of pushing such a large amount of derivatives out of the bank. First, in order to achieve centralized risk management across multiple swap entities, there would have been an increase in intercompany bookings. Second, operational risks would have arisen in the course of transferring thousands of client relationships to push-out affiliates. In addition, requiring clients to face a swap provider that is different from the bank with which they had a lending or other business relationship would have complicated existing client activities and may not have been feasible under certain existing client relationship documentation. Some clients may well have chosen to deal less with JPMCB or other U.S. banks, instead turning to European universal banks that present none of these risk management or operational problems. The United States is the only jurisdiction that has proposed or adopted any provision similar to Section 716, with the exception of the ring-fencing of core financial services and activities in the United Kingdom.

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[4] Bernanke Letter ("Forcing these [derivatives] activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities.")

[5] Bair Letter.

[6] *The Economic Outlook: Hearing Before the Joint Economic Committee*, 113th Cong. 81-472 (2013) (statement of Hon. Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System).

Section 630 leaves intact the provision in Section 716 that permits banks to use derivatives to engage in hedging and other similar risk management activities directly related to banks' activities. As recognized by Congress with the passage of Section 716, the ability of banks to use derivatives for hedging purposes is crucial for mitigating the risks of banks' normal banking activities. JPMCB enters into derivatives to hedge the currency, interest rate, credit and other risks associated with its securities, loan, derivatives and other asset portfolios. JPMCB interprets hedging activities to mean those activities that are designed to reduce or otherwise mitigate one or more specific risks arising in connection with and related to identified positions, contracts or other holdings of JPMCB. This basic definition of hedging is consistent with the definition of hedging in the final Volcker regulations and is one that JPMCB has experience using for purposes of complying with other banking regulations. JPMCB has been using this definition in preparation for the implementation of Section 716 since the passage of the Dodd-Frank Act in 2010.

As noted above, Section 630 requires that banks that are swap dealers push out "structured finance swaps" as defined in Section 630. The principal types of structured finance swaps currently executed in JPMCB include total return swap indices that reference asset-backed securities indices, such as ABX (subprime residential MBS indices), BMX (residential agency MBS indices), IOS (indices referencing the interest component of residential agency MBS), PO (indices referencing the principal component of residential agency MBS) and TRX (commercial MBS indices), and, to a lesser extent, credit default, total return or other swaps referencing single-name asset-back securities. These swaps, where executed in a non-hedging capacity, will be pushed out to affiliates of the bank by the July 16, 2015 compliance deadline.

I am not in a position to provide the swaps data that you requested in questions 2 and 6 in your letter because it is confidential commercial or financial data, the disclosure of which could result in a competitive disadvantage.[7] In addition, our correspondence with the Office of the Comptroller of the Currency (the "OCC") relating to an extension of Section 716 is non-public OCC information, the disclosure of which requires the OCC's prior approval.[8] I have requested permission from the OCC to share such correspondence with you. I note, however, that the information in the correspondence also contains confidential commercial or financial data.

Sincerely,

Diane Genova

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[7] 12 CFR §4.12(b)(4).

[8] 12 CFR §4.36.