Bank of America

John Collingwood
Senior Vice President
Federal Government Relations

February 26, 2015

The Honorable Elizabeth Warren
Ranking Member
Senate Banking Subcommittee on
Economic Policy
317 Hart Senate Office Building
Washington, DC 20510

The Honorable Elijah Cummings
Ranking Member
House Committee on Oversight and
Government Reform
2471 Rayburn House Office Building
Washington, DC 20515

Dear Senator Warren and Representative Cummings:

This letter is to respond to your January 29, 2015 request to Bank of America regarding Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the changes to that provision included in Section 630 of the 2015 Consolidated and Further Continuing Appropriations Act.

As a preliminary matter, we note that the data about our derivatives portfolio requested in your letter is based on notional amount, which is widely accepted as having no demonstrable correlation to actual risk and is thus not a meaningful measure of potential exposures.

Notional amount significantly overstates risks and fails to account for how credit risk is managed and mitigated. Conversely, we believe mark-to-market credit exposures and potential credit exposure measurements, such as those used by banking regulators in risk-based capital rules, are better measurements of risk and represent a small fraction of notional amount. Factors that are pertinent in evaluating risks relating to derivatives include:

- Netting of exposures with a single counterparty under a master netting agreement;
- Intermediation of risk positions between counterparties that offset market risk;
- Extent to which a derivative is collateralized by the posting of variation or initial margin;
- Clearing trades that moves exposure away from the client to central clearing counterparties; and
- Impact of risk-reducing hedges.

All banks are subject to routine examination and supervision with respect to adherence to internal risk management guidelines and exposure limits that must be consistent with prudential guidelines promulgated by banking regulators. Therefore, we would respectfully urge that any evaluation of the effects of Section 716 and its recent changes should be considered in the context of actual risks rather than simply a calculation of the notional amount of trades.

It is also worth pointing out that the "Volcker Rule" (Section 619 of the Dodd-Frank Act) continues to apply. Accordingly, all transactions are conducted for permissible business reasons such as customer

Tel: 202.661.7130 • Fax: 202.661.7110
john.collingwood@bankofamerica.com

Bank of America, DC8-455-09-01
1455 Pennsylvania Avenue, NW, 9th Floor, Suite 950, Washington, DC 20004-1043

intermediation and risk-mitigating hedging and not for prohibited proprietary or speculative purposes. In addition, using industry-wide data from the FDIC's most recent Depository Institutions Report (September 30, 2014), we estimate that under the original Section 716 language, only approximately 2% of the aggregate mark-to-market exposure of all derivatives would have been pushed out of banks.

We have endeavored to answer fully the questions you have posed; nevertheless, in certain cases we are constrained by laws prohibiting disclosure of confidential supervisory information and our obligation to protect proprietary and competitively sensitive information.

Question 1: The definition of the term "hedging" and "risk management purposes" that your firm will use to determine which swaps trades can now be made under Section 630.

We will apply a definition to the terms "hedging" and "risk management purposes" that is comparable to the risk-mitigating hedging and market-making hedging exemptions from the prohibition on proprietary trading under the Volcker Rule. Under the Volcker Rule, structured finance swaps activity (including anticipatory and dynamic hedging activity) that is (i) designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks within the bank, including hedging in conjunction with market-making activities, or (ii) entered into in connection with individual or aggregated positions, contracts or other holdings, is a permitted activity for hedging or risk management purposes.

Question 2: The total value of derivatives contracts your institution holds for each of "hedging" and "risk management purposes" and the total value of swaps derivatives contracts your institution holds for each of these purposes.

This is proprietary, competitively sensitive information that we have an obligation to protect and thus elect not to provide.

Question 3: The types of transactions included in the term "structured finance swap" as used in Section 603 of the omnibus bill and the value of these transactions.

At this time, we have determined that the following transaction types would be considered "structured finance swaps":

- Single-name credit-default swaps (CDS) and total-return swaps (TRS) referencing asset-backed securities (ABS);
- CDS and TRS indices referencing ABS or referencing a basket primarily composed of ABS (e.g., Markit ABX, TABX, CMBX, PrimeX, and TRX swaps); and
- TRS referencing the interest and/or principal components of ABS (e.g., Markit MBX, IPS, and PO RMBS swaps).

We may revise or augment the above as we continue to evaluate the types of transactions that will be included under the definition of "structured finance swap." The value of these transactions is proprietary, competitively sensitive information that we have an obligation to protect and thus elect not to provide.

Question 4: Copies of your institution's application to the OCC to delay implementing Section 716, including any supplemental materials provided with this application.

We consider any applications, communications or other materials that Bank of America, N.A. may have shared with or submitted to the OCC to be confidential supervisory information. We are prohibited, under applicable Federal law and OCC guidelines, from disclosing any such information.

Question 5: A description of any "operation and credit risks" your institution would have experienced had it been required to implement the provisions of Section 716 and any information related to actuarial measures of risk associated with the swaps your institution would have "pushed out" under Section 716 absent the changes in Section 630 of the omnibus bill.

Section 716 as adopted in the Dodd-Frank Act would have raised the cost to end-users of managing their risks through the use of derivatives without any improvements in bank safety and soundness. From a safety and soundness perspective, Section 716 would have hindered banks' ability to centrally manage their derivatives risk while at the same time "pushing out" certain activities into entities that are not subject to the strict prudential regulation of a bank. Moreover, it is most efficient for a bank holding company to hedge the risk associated with its activities in a central legal entity, and bifurcating client derivatives activity and the associated risk management hedges creates unneeded complexity and challenges to risk management.

The concerns around risk management were echoed by Federal Reserve Board of Governors Chairman Ben Bernanke in his May 12, 2010 letter to Senate Banking Committee Chair Chris Dodd (D-CT), where Chairman Bernanke stated that "[p]rohibiting depository institutions from engaging in significant swaps activities will weaken the risk mitigation efforts of banks and their customers." In his letter, Chairman Bernanke clearly sets forth the rationale for his statement based on a real-world example of how a bank manages risk with derivatives. [i]

End-users would no longer be able to face a bank entity to manage their risk with certain derivatives because those activities would have been "pushed out" under the original Section 716 requirement, and they would be forced to trade with a non-bank "swaps entity" or broker-dealer. Nevertheless, the end-users would likely continue facing the bank for interest rate swaps or other non-"pushed out" products. Facing multiple entities for swaps activity would create unneeded operational complexity for the end-user, and the end-user would lose the benefit of netting close-out obligations and collateral.

Question 6: The total value of swaps your institution would have "pushed out" under Section 716 absent the changes in Section 630 of the omnibus bill and the total value of swaps your institution now expects to "push-out."

Information related to exact volumes and values of swaps expected to be "pushed out" from Bank of America, N.A. is proprietary, competitively sensitive information that we are obligated to protect and thus elect not to provide. As we stated earlier, using industry-wide data from the FDIC's most recent Depository Institutions Report (September 30, 2014), we estimate that under the original Section 716 language, only approximately 2% of aggregate mark-to-market exposure of all derivatives would have been pushed out.

We hope that this helps answer some of your questions.

Sincerely,

John E. Collingwood
Director, Federal Government Relations

[i] Excerpt from letter, dated May 12, 2010, from Federal Reserve Board of Governors Chairman Ben Bernanke to Senate Banking Committee Chair Chris Dodd (D-CT):

> Prohibiting depository institutions from engaging in significant swaps activities will weaken the risk mitigation efforts of banks and their customers. Depository institutions use derivatives to help mitigate the risks of their normal banking activities.
>
> For example, depository institutions use derivatives to hedge the interest rate, currency, and credit risks that arise from their loan, securities, and deposit portfolio. Use of derivatives by depository institutions to mitigate risks in the banking business also provides important protection to the deposit insurance fund and taxpayers as well as to the financial system more broadly. In addition, banks acquire substantial expertise in assessing and managing interest rate, currency, and credit risk in their ordinary commercial banking business. Thus, banks are well situated to be efficient and prudent providers of these risk management tools to customers.
>
> Importantly, banks conduct their derivatives activities in an environment that is subject to strong prudential Federal supervision and regulation, including capital regulations that specifically take account of a bank's exposures to derivative transactions.
>
> The Basel Committee on Banking Supervision has recently proposed tough new capital and liquidity requirements for derivatives that will further strengthen the prudential standards that apply to bank derivative activities. Titles I, III, VI, VII and VIII of S.3217 all add provisions further strengthening the authority of the Federal banking agencies and other supervisory agencies to address the risks of derivatives. Section 716 would force derivatives activities out of banks and potentially into less regulated entities or into foreign firms that operate outside the boundaries of our Federal regulatory system. The movement of derivatives to entities outside the reach of the Federal supervisory agencies would increase, rather than reduce the risk to the financial system. In addition, foreign jurisdictions are highly unlikely to push derivatives business out of their banks. Accordingly, foreign banks will have a competitive advantage over U.S. banking firms in the global derivatives marketplace, and derivatives transactions could migrate outside the United States.