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February 26, 2015

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

The Honorable Elijah Cummings
Ranking Member, House Committee on Oversight and Government Reform
2235 Rayburn House Office Building
Washington, DC 20515

Dear Senator Warren and Congressman Cummings:

I appreciate the opportunity to share with you Citi's views on the potential impact of Section 716 ("swaps push-out") of the Dodd-Frank Act on our customers and our business, and the bipartisan provision (formerly H.R. 992) addressing this provision's most problematic elements. This is a serious matter to which we have given much careful thought and we look forward to briefing your staffs on this issue. We reached out to the staff member specified in your letter, who indicated a preference to schedule a briefing after receipt of this letter. In advance of that briefing, we are pleased to provide the following written response that goes into some detail on our position on, and the history of, this important issue.

Citi has been and remains a strong supporter of the Dodd-Frank Act. Dodd-Frank has strengthened our financial system, but the "swaps push-out" provision has always been an exception, as many of the law's strongest supporters—and even one of its authors—have acknowledged since the provision was originally proposed.

A range of stakeholders have expressed key concerns with the "swaps push-out" provision of Section 716 as passed in Dodd-Frank. First, the measure would have run counter to Dodd-Frank's objectives by working at odds with the resolution reforms designed to end "too big to fail." Second, Dodd-Frank already contains significant reforms that are more effective than "swaps push-out" at reducing risk in the financial system. Third, "swaps push-out" would have imposed substantial, unnecessary complications and costs on the clients of American banks, likely resulting in a loss of those clients to overseas banks.

That's why banks of all sizes supported the modification of the "swaps push-out" provision. This letter will explain in more detail these concerns. It is also important to clarify the circumstances and process by which Congress considered the change to Section 716 ("the modification") that was passed as part of the 2015 Consolidated and Further Continuing Appropriations Act.

Background on the Legislative Modification of Section 716 of Dodd-Frank

Section 716 as enacted in Dodd-Frank would have required FDIC-insured banks that are registered swap dealers to spin off certain derivatives transactions—namely certain commodity, equity and un-cleared credit default derivatives—into separate non-FDIC insured units. Under the originally enacted language,

foreign exchange and interest rate swap transactions were still allowed to be conducted in an FDIC-insured bank.

Section 716 was inserted into the Dodd-Frank Act at the eleventh hour—with little debate—and it was criticized by the Federal Reserve, the FDIC, Paul Volcker, and even by Representative Barney Frank himself.

By contrast, the process to amend the "swaps push-out" provision was lengthy, transparent, robust and bipartisan, as the following timeline illustrates.

Congress began debating changes to Section 716 in 2011 and took the following actions in the succeeding years:

- February 16, 2012: The House Financial Services Committee voted to pass—by voice vote, which means support was unanimous—a bipartisan amendment (H.R. 1838) to modify "swaps pushout" that was very close in language to the legislation signed into law in 2014.
- March 6, 2013: The Senate companion bill (S. 474) was introduced with bipartisan support.
- March 20, 2013: The House Agriculture Committee passed The Swaps Regulatory Improvement Act (H.R. 992) by a bipartisan vote of 31-14. The identical language of H.R. 992 is contained in Section 630 of the 2015 Consolidated and Further Continuing Appropriations Act.
- May 7, 2013: The House Financial Services Committee also passed H.R. 992 by a bipartisan vote of 53-6.
- October 30, 2013: The full House of Representatives voted 292-122 to pass H.R. 992 and to send it to the Senate for consideration.
- June 25, 2014: The House Appropriations Committee included the text of H.R. 992 as an
 amendment—again, by voice vote—during the full Committee markup of the House Financial
 Services and General Government Appropriation Bill (H.R. 5016), in cooperation with the House
 authorizing committees.
- July 16, 2014: H.R. 5016, with the language of H.R. 992 included in the bill, was fully debated and passed in the House by a vote of 228-195.
- December 16, 2014: President Obama signed The Consolidated & Further Appropriations Act of 2015 (H.R. 83), which included the language of H.R. 992 modifying Section 716 of the Dodd-Frank Act.

The modification of the "swaps push-out" provision did not repeal, nor did it seek to repeal, Section 716 of Dodd-Frank. In fact, it reaffirms that certain structured finance credit default swaps on asset-backed securities, which were the only type of swap that collapsed in the financial crisis, would still be "pushed out" of FDIC-insured banks. Under the amended Section 716, commodity swaps, equity swaps, and credit default swaps that are not structured finance swaps are now allowed to be transacted in an FDIC-insured entity. The modification also keeps intact the multiple protections included in Section 716

against using taxpayer assistance to support the U.S. bank's swaps activity, and does not alter the Volcker rule. Here is the relevant language:

- (1) ... (n)o federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity. (12 U.S.C. § 5511 Sec. 716(a))
- (2) No taxpayer funds shall be used to prevent the receivership of any swap entity resulting from swap or security-based swap activity of the swaps entity. (12 U.S.C. § 5511 Sec. 716(i)(1)(a))
- (3) Taxpayers shall bear no losses from the exercise of any authority under this title. (12 U.S.C. § 5511 Sec. 716(i)(3))

Specific Concerns Regarding "Swaps Push-Out"

As noted above, Citi and other American banks—large, small and medium alike—supported the modification to Section 716 for three fundamental reasons.

1. The Enacted Language Would Have Made the Financial System Less Safe by Undermining Orderly Resolution

Section 716 as enacted in Dodd-Frank would have complicated the ability of regulators to bring about the orderly resolution of systemically-significant institutions. By requiring some swaps to be scattered across multiple legal vehicles, it proposed to make resolution more complex and disruptive. As leading economist Mark Zandi noted in a letter supporting repeal of Section 716:

[i]t causes firms to segment the derivatives with individual counterparties and requires another entity be created to engage in the pushed-out transactions. Creating new operations, and expending additional capital to make them robust enough, is in contrast to the resolution planning objectives of eliminating entities and simplifying structure. During the wind down of either the financial institution or of the counterparty, the breaking up of the derivatives activities creates additional risks because separate entities will not be able to net their exposures like they can if they are facing one entity only. ¹

Simply put, pushing derivative activity into less-regulated markets is likely to increase, not decrease, systemic risk.

2. Dodd-Frank Already Requires Significant Derivative Reforms to Make the System Less Risky

The derivatives reforms enacted in Title VII of Dodd-Frank have brought major beneficial changes to the marketplace. Regulators now have better tools to ensure that taxpayer funds are not at risk and that there is greater protection against contagion to the broader economy from a distressed bank.

For instance, Title VII imposes new mandates to centrally clear standardized swaps through clearinghouses; it creates transparency through trade reporting to regulators; requires that swaps be traded on exchanges or swap execution facilities; it sets higher capital levels for the biggest dealers; and it mandates the collection of margin for un-cleared swaps from counterparties.

¹ Letter from Mark Zandi to House Financial Services Capital Markets Subcommittee dated November 14, 2011.

In addition to the important derivatives reforms, other landmark changes such as Volcker Rule prohibitions on speculative proprietary trading, increased capital requirements on large financial firms, improved liquidity guidelines with more reliance on stable funding sources, and the stress tests have all made the financial sector safer and sounder.²

3. Section 716 as Originally Enacted Would Have Harmed Businesses, Hurt Banks of All Sizes, and Impaired American Competitiveness

Section 716 as originally enacted would have been expensive to implement for companies that transact commodities and equities swaps with financial institutions of all sizes and that seek a diverse range of products to manage their risk. Clients who transact with banks such as Citi on foreign exchange and interest rate swaps would have faced higher credit and margin posting costs if they had also entered into equity or commodity swaps because they would not be able to net their rate and foreign exchange swaps with equity or commodity swaps. Banks would have had to pass on those higher costs to clients, who in turn would have had to pass them on to consumers, raising the price of goods and services for everyone, with no increase in systemic safety.

It was not just the so-called "big banks" that would have faced these higher costs. Smaller banks—for instance, banks specializing in agriculture transactions—would have faced the same cost issues with their customers. Indeed, banks of all sizes—including community and regional banks—would have been harmed by the application of Section 716 as enacted. In fact, some of the banks that would have been most negatively impacted are small banks that engage in commodities trading for their customers. (See ABA Backgrounder attached.)

Furthermore, the "swaps push-out" provision would have forced clients of Citi and other American banks to deal with more than one entity depending on the type of swap needed, instead of the "one stop banking" that companies currently expect. As a result, most such clients would have faced strong incentives to abandon American banks in favor of overseas competitors not subject to this rule.

And the provision would have created all these negative effects without increasing systemic safety. To the contrary, it probably would have weakened systemic safety by introducing unnecessary complexity into the financial system and pushing swaps into foreign banks.

² Representative Barney Frank (D, MA), Ranking Member on the House Financial Services Committee stated during passage in 2012 of a modification to this Dodd-Frank provision (H.R. 1838):

[[]i]n addition to the substantive regulation of derivatives, calling for them to be on exchanges, calling for margin, for capital when they're between financial institutions, requiring price transparency in every case, in addition to those, we also have legislation that restricts what banks can do on their own account versus—rather than for customers. This section [Section 716] . . . came on top of both of those. And I never myself thought that it made a great deal of sense, but we did need 60 votes in the United States Senate to pass this bill . . .

I thought this [Section 716] did not add a great deal—it added nothing in terms of protection and I just want to reassure people, passing this bill . . . will not in any way, shape or form reduce sensible regulation of derivatives. It will not increase any exposure to the financial system from derivatives. [Section 716] was an unnecessary and, I think, somewhat unwise amendment. The bill before us, particularly as amended, will restore this to what I think is the appropriate balance. (Transcript from House Financial Services Committee, Rep. Barney Frank remarks, February 16, 2012.)

As former Federal Reserve Chairman Ben Bernanke observed in Congressional testimony:

716 requires the push-out of certain kinds of derivatives, which means the banks can't manage those derivatives, they have to be in a separate -- a separate company, a separate affiliate. And it's not evident why that makes the company as a whole safer. And what we do see is that it will likely increase costs of people who use the derivatives and make it more difficult for the bank to compete with foreign competitors who can provide a more complete set of services. So there are some concerns about that particular rule.³ (Emphasis added.)

Response to Questions Regarding Citi Trading Data

U.S. law prohibits Citi from providing material non-public information on a selective basis. Accordingly, the below responses are derived from Citi's September 30, 2014 Consolidated Reports of Condition (CALL) report as filed with the U.S. banking regulators.

- (1) With respect to the definition of the term "hedging" and "risk management purposes," Citi will comply with requirements as set out in the revised Section 716, and in a manner consistent with other parts of the Dodd-Frank Act, including the Volcker Rule;
- (2) The current structure of CALL report does not require U.S. banks to break out the total value of "derivatives" contracts (or "swaps derivatives") held for "hedging" and "risk management purposes." This is a new requirement and is embedded in Section 716 of Dodd-Frank—the original language and as revised. Citi is focused on fully complying with all Dodd-Frank requirements by the required deadlines.
- (3) A "structured finance swap" under revised Section 716 means "a swap or security-based swap based on an asset-backed security (or group or index primarily comprised of asset-backed securities." We believe a swap based on the following Markit indices—ABX, CMBX, MBX, TABX, TRX and MBX—would be included within the term "structured finance swap." Citi does not have specific information on the size of the market for these products and other structured finance swaps, but we understand that since the financial crisis these markets have been and remain very small.
- (4) Attached as Exhibit A is the public version of Citi's January 31, 2013 application for an initial Section 716 transition period. Pursuant to a notice of proposed rulemaking issued by the Comptroller of the Currency dated January 2, 2013, the OCC approved requests for an initial transition period under Dodd-Frank Section 716 in the spring of 2013.
- (5) As set out in the public portion of Citi's January 31, 2013 application for an initial transition period under Dodd-Frank Section 716:

The Requested Transition Period will help Citibank and its clients in mitigating the impact from the loss of netting efficiencies due to bifurcated portfolios. Citibank's critical concern regarding a pre-mature effectiveness of Section 716 is that the sequencing of other Title VII requirements, particularly mandatory

³ Transcript from Hearing in House Financial Services Committee February 27, 2013.

clearing, has been delayed by at least two years. Clearing of swaps significantly mitigates the impact to clients and Citibank from having bifurcated portfolios and the resulting loss of netting and increased credit exposure. Implementation of mandatory clearing for all swap products commences

March/June/September 2013 for Wave 1 CFTC products, and is estimated to take at least two years for clearable products in all asset classes.

(6) In Citi's September 30, 2014 CALL Report, the columns in Schedule RC-L—Derivatives and Off-Balance Sheet Items, line 12.e—do not align with the definitions of those swaps that were subject to or eligible for an exemption under the 2010 version of Section 716.

Further, Columns C and D in line 12.e relate to swaps currently on Citi's balance sheet as of September 30, 2014. Pursuant to paragraph (e) of the 2010 version of Section 716, an otherwise covered swap that already exists in a U.S. depository institution prior to the end of the transition period (July 16, 2015) is permissible under the statute. Hence, the 2010 version of Section 716 would not have required Citi to "push out" any existing covered swaps, and only discontinue transacting in any new covered swaps.

With respect to structured finance swaps, as stated above, the markets for structured finance swaps have since the financial crisis been very small. Accordingly, Citi does not engage in a material amount of such activity. Citi will be in full compliance with Section 716 by July 16, 2015, and thus will not be permitted to enter into any new structured finance swaps that are not otherwise for "hedging or risk management purposes."

As noted above, Citi has consistently been and remains a strong supporter of the financial reforms enacted through Dodd-Frank and the many other U.S. and international measures to strengthen the American and global financial systems. Since the financial crisis—both as a result of our own initiative and in response to these reforms—Citi has become a simpler, smaller, safer and stronger company. The firm's capital and liquidity levels have been rebuilt far beyond what they had been even before the crisis. We've shed more than 60 non-core businesses and \$700 billion in non-core assets. And we've completely overhauled our governance, compliance and risk management structures. In short, Citi is a fundamentally different company than it was before and during the financial crisis.

I appreciate your providing us with the opportunity to clarify the history of the "swaps push-out" modification and to familiarize you with the progress Citi has made since the financial crisis.

Sincerely,

Carl V. Howard

Deputy General Counsel

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Citigroup

Citibank, N.A. Request for a Transition Period Under Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

I. Introduction

A. Scope of Request

Pursuant to the Notice of Guidance ("Transition Period Guidance") issued January 3, 2013 by the Office of the Comptroller of the Currency (the "OCC") with respect to the transition period contemplated under Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection ("Dodd-Frank Act" or the "Act"), Citibank, N.A. ("Citibank" or "CBNA") requests a two-year transition period for nonconforming swap activities under Section 716, commencing from July 16, 2013 and expiring on July 15, 2015 (the "Requested Transition Period").

The Dodd-Frank Act was enacted on July 21, 2010, but much of the rulemaking necessary to implement the derivatives reforms in Title VII of the Act have been delayed by two years or more. Clarity on mandatory clearing, swap execution facilities, margin and capital, cross-border issues and international harmonization of derivatives rules, just to name a few areas, remain years away¹. Nevertheless, on December 31, 2012, Citibank registered with the CFTC as a swap dealer – accordingly, Citibank is a "swaps entity" for purposes of Section 716. As a "swaps entity", unless a transition period is granted, beginning July 16, 2013 no Federal assistance may be provided to Citibank with respect to certain types of swap activity entered into after that date.

For the reasons stated in the OCC's Transition Period Guidance and herein, the Requested Transition Period of two years is justified and consistent with the statutory mandate of Section 716 that provides that the OCC "shall permit" a transition period of up to 24 months.

the Requested Transition Period of two years is consistent with the objectives of the OCC identified in the Transition Period Guidance:

• A transition period will provide insured depository institutions an opportunity to conform their swaps activities in an orderly manner.

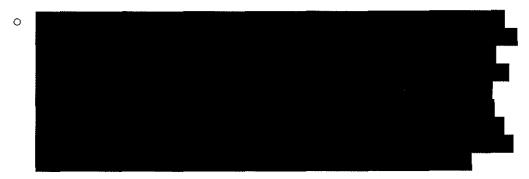


The Commodity Futures Trading Commission (the "CFTC") and Securities Exchange Commission ("SEC") have yet to issue final cross-border guidance resolving in final the treatment of Citibank's overseas branches and overseas subsidiaries

U.S. and non-U.S. branches.

[.] For the avoidance of doubt, Citibank's Requested Transition Period covers its

• A transition period will mitigate potential disruptions to the clients of insured depository institutions.

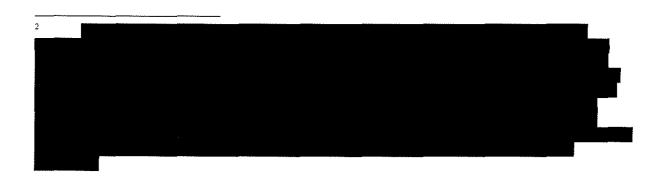


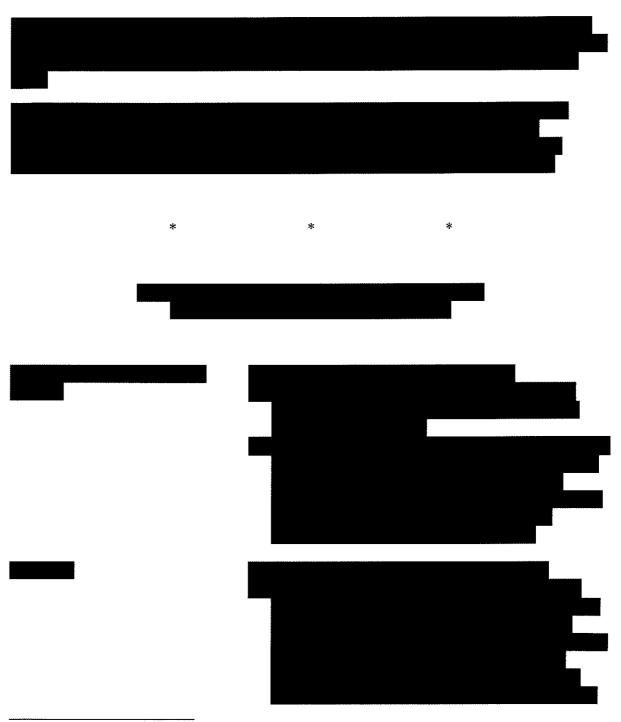
 A transition period will mitigate operational and credit risks for insured depository institutions.



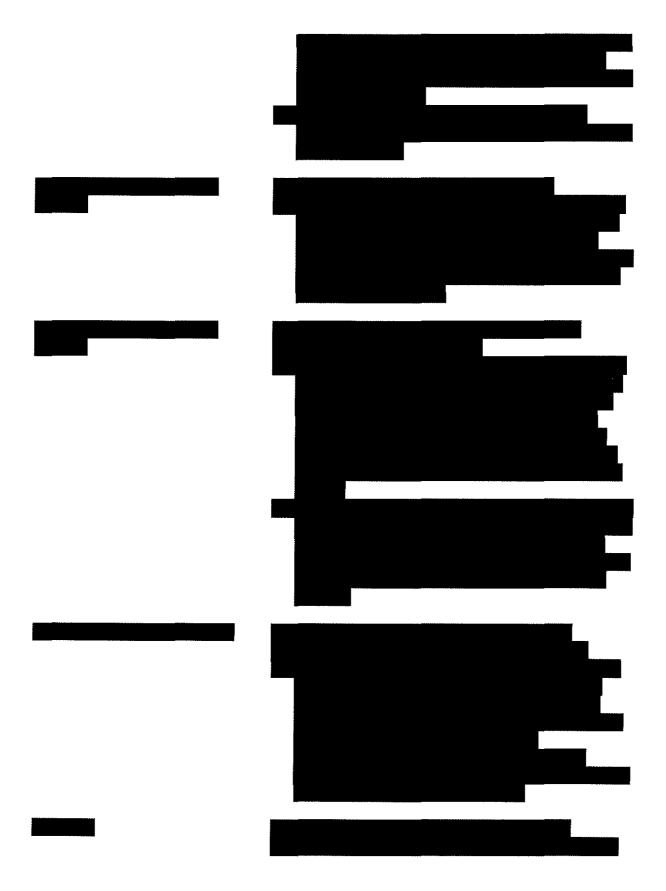
II. Citibank's Preliminary Plan for Conforming Its Swap Activities

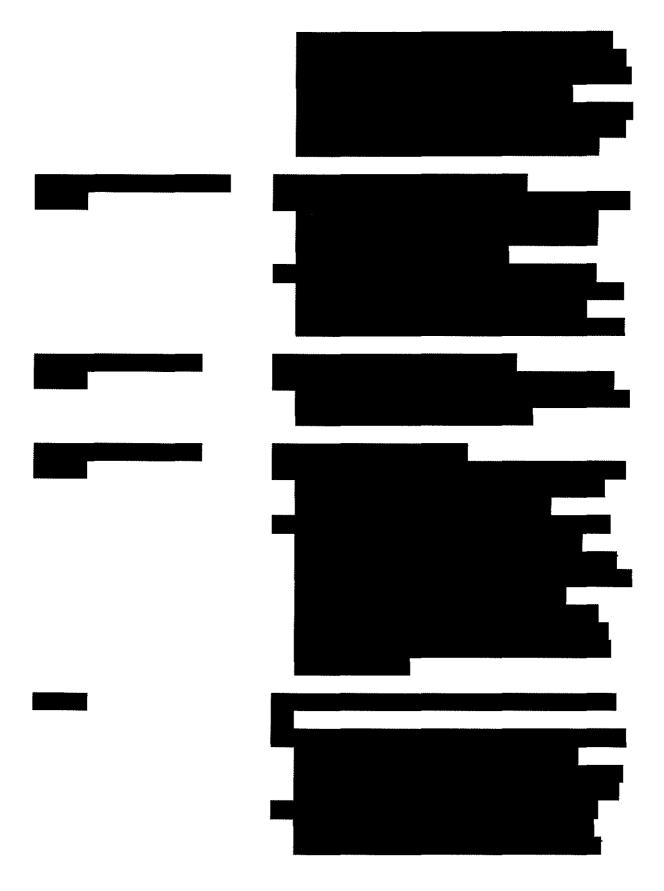
The following represents Citibank's preliminary plan to conform its swap activities to Section 716, assuming the Requested Transition Period is granted and Citibank's Section 716 conformance date is July 16, 2015. As illustrated below, the Requested Transition Period of two years is justified because of significant uncertainty surrounding critically inter-dependent U.S. and non-U.S. derivatives rulemaking.

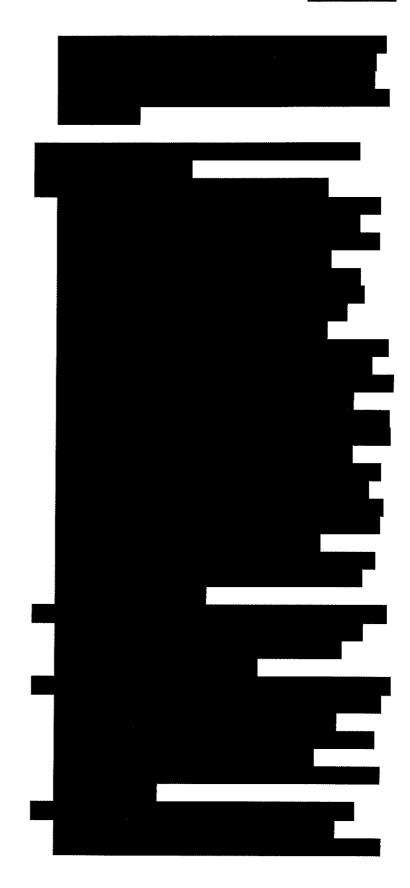


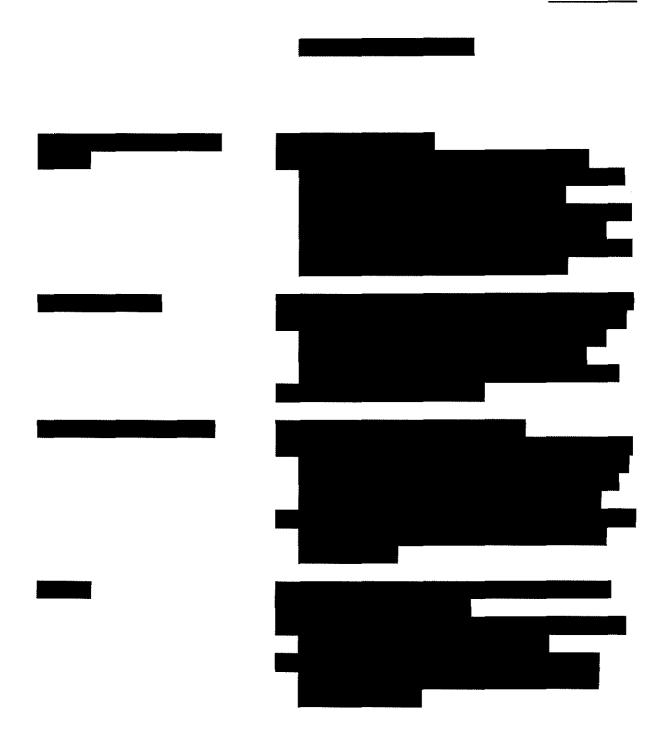


On December 4, 2012, the CFTC issued a joint statement with other U.S. and non-U.S. regulators regarding operating principles and areas of exploration in the regulation of the cross-border OTC derivatives market. The statement recognized that "difference in implementation dates may create gaps in regulations and uncertainty in the application of certain cross-border regulatory requirements, and may lead to risks to financial markets that are unaddressed, to regulatory arbitrage, and to an uneven playing field for market participants, intermediaries and infrastructures." The statement also included a commitment to continue to work together to refine the concepts of recognition and substituted compliance, and continued consultation in a timely manner about respective processes. CFTC Press Release PR6439-12 (December 4, 2012).





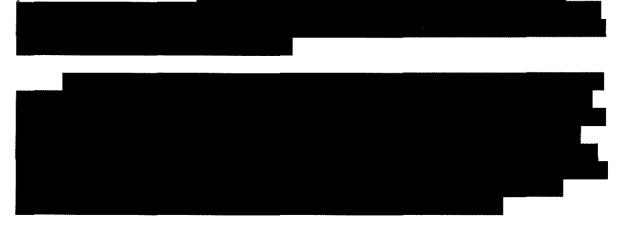




III. How the Requested Transition Period Would Mitigate Adverse Effects On Mortgage Lending, Small Business Lending, Job Creation, And Capital Formation

The Requested Transition Period will help Citibank and its clients in mitigating the impact from the loss of netting efficiencies due to bifurcated portfolios. Citibank's critical concern regarding a pre-mature effectiveness of Section 716 is that the sequencing of other Title

VII requirements, particularly mandatory clearing, has been delayed by at least two years. Clearing of swaps significantly mitigates the impact to clients and Citibank from having bifurcated portfolios and the resulting loss of netting and increased credit exposure. Implementation of mandatory clearing for all swap products commences March/June/September 2013 for Wave 1 CFTC products, and is estimated to take at least two years for clearable products in all asset classes.



While post-effectiveness of Section 716 clients will be unable to transact with Citibank certain types of swaps, including uncleared credit default swaps, commodity swaps and equity swaps, the Requested Transition Period will permit Citibank to transition to the requirements of Section 716 in a more orderly fashion, and with less harm and disruption to clients and Citibank, and, in turn, the swaps markets generally – thus, mitigating adverse effects on mortgage lending, small business lending, job creation and capital formation.

IV. The Extent To Which The Requested Transition Period Could Have a Negative Impact on the Institution's Insured Depositors and the DIF

Citibank is a highly capitalized and liquid national bank, and a well-accepted counterparty on derivatives. As discussed above, Citibank believes a pre-mature effectiveness of Section 716 without the statutory contemplated transition period would harm Citibank and clients, and, in turn, the swaps markets generally. Maintaining the earnings stability and preserving the client relationships of Citibank will ensure a safer and sounder Citibank, which furthers the interests of, rather than causing a negative impact on, Citibank's insured depositors and the DIF.

V. <u>Operational Risks and Other Safety and Soundness Concerns That a Transition Period Would Mitigate</u>

As discussed above, pre-mature effectiveness of Section 716 without the Requested Transition Period of two years will disrupt client relationships, and require a renegotiation of client documentation and a build out of systems.



VI. Conclusion -- Other Facts That The Institution Believes the OCC Should Consider

Citibank recognizes that ultimately, the implementation of Section 716 will require certain swaps to be undertaken by an affiliate that is not an insured depository institution, and Citibank is committed to conforming to Section 716. But in this context, the OCC should strive for phasing in Section 716 in the manner contemplated in Section 716 – following appropriate transition periods. The primary goal of Citibank's Requested Transition Period is to have Section 716 effective after mandatory clearing because of the risk-mitigating effects of clearing for Citibank and its clients. For these and the above reasons, Citibank requests that the OCC approve the Requested Transition Period.



Backgrounder

ABA Media Contact:

December 2014

Jeff Sigmund jsigmund@aba.com, 202-663-5439

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



Backgrounder

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 <u>did not</u> 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.

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