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REP. SCOTT GARRETT HOLDS A MARKUP ON H.R. 1838

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COMMITTEE HEARING

REP. SCOTT GARRETT

CHAIRMAN

HOUSE COMMITTEE ON FINANCIAL SERVICES, SUBCOMMITTEE ON CAPITAL

MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

WASHINGTON, D.C.

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HOUSE COMMITTEE ON FINANCIAL SERVICES, SUBCOMMITTEE ON
CAPITAL MARKETS AND GOVERNMENT-SPONSORED ENTERPRISES
HOLDS A MARKUP ON H.R. 1838

NOVEMBER 15, 2011

SPEAKERS:

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REP. JEB HENSARLING, R-TEXAS
REP. PETER T. KING, R-N.Y.
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REP. BILL POSEY, R-FLA.
REP. MICHAEL G. FITZPATRICK, R-PA.
REP. NAN HAYWORTH, R-N.Y.
REP. ROBERT HURT, R-VA.
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REP. ROBERT DOLD, R-ILL.
REP. SPENCER BACHUS, R-ALA.

EX OFFICIO

REP. MAXINE WATERS, D-CALIF.

RANKING MEMBER

REP. GARY L. ACKERMAN, D-N.Y.

REP. BRAD SHERMAN, D-CALIF.

REP. RUBEN HINOJOSA, D-TEXAS

REP. STEPHEN F. LYNCH, D-MASS.

REP. BRAD MILLER, D-N.C.

REP. CAROLYN B. MALONEY, D-N.Y.

REP. GWEN MOORE, D-WIS.

REP. ED PERLMUTTER, D-COLO.

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REP. ANDRE CARSON, D-IND.

REP. JIM HIMES, D-CONN.

REP. GARY PETERS, D-MICH.

REP. AL GREEN, D-TEXAS

REP. KEITH ELLISON, D-MINN.

REP. BARNEY FRANK, D-MASS.

EX OFFICIO

GARRETT: This brings us now to consideration of 1838, a bill dealing with Section 716 of the legislation. The clerk shall report the bill.

(UNKNOWN): H.R. 1838, to repeal a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibiting any federal bailout of swap dealers or participants.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, Section 1 Repeal.

Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act is repealed.

GARRETT: The clerk has completed reading the amendment. The gentlelady from New York is recognized as soon as she's ready...

HAYWORTH: I'm ready.

GARRETT: ...for five minutes on the -- on the bill.

HAYWORTH: Thank you, Mr. Chairman.

GARRETT: The gentlelady is recognized.

HAYWORTH: Thank you, Mr. Chairman.

First, I'd like to reiterate my commitment to working with members of -- all the members of our committee on both sides of the committee on language that everyone here can support.

And in service of that goal a little later in this hearing for which I thank the chairman, I'll be proposing an amendment that reflects specific concerns raised by our Democratic colleagues during the previous hearing. And I'm very hopeful that this amendment will be a sign of our good faith efforts to create a cross-party consensus on this issue.

716 -- Section 716 of Dodd-Frank requires banks to push out -- in the term of art -- push out certain swap transactions into affiliates. The biggest classes of swaps -- interest rate swaps and exchange rate swaps are exempted from that push out requirement, so 716 ends up only applying to a small number of swaps, namely equity, commodity, and credit default swaps.

There has been broadly based objection among knowledgeable parties not least of whom are Ben Bernanke, Sheila Bair, Paul Volcker during the creation of Dodd-Frank, but broadly based objection to 716 is actually creating more risk than it might mitigate.

Banks are the heaviest regulated and the safest entities within bank-holding companies. They are regulated by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation where its affiliates are only regulated by the Federal Reserve, and SEC, and the CFTC. And, of course, unfortunately during the 2008 crisis, that was not optimal.

Banks are also the most heavily capitalized within holding companies because they maintain their excess capital within the banks themselves, which is why bank customers specifically want to face the bank rather than affiliates. They certainly most secure facing the bank when they are conducting their swaps activities.

Section 716, therefore, is extremely burdensome to banks because the affiliate would have to be heavily capitalized to satisfy the market demands of customers and the estimates of the unnecessary costs which, of course, are locked up capital, which takes away from job creation our essential job here in this Congress. But estimates of the unnecessary costs associated with these changes, with this capitalization, with this creation of relationships.

Aside from the inconvenience and the cost to the banks customers who would have to deal with two different entities, the estimates of the cost are the billions of dollars. And again, we need to spend those dollars on investment and on job creation.

Very recently, Mark Zandi, who is the chief economist at Moody's Analytics has also supported the repeal of Section 716. And in his letter, which I'm going to ask to be entered into the record later, he points out that the section impedes orderly liquidation actually and is unnecessary to prevent bailouts because of the other provisions within Dodd-Frank.

And he concludes, I'm quoting here, "I have significant concerns with this part of the law because of its potential to increase systemic risk, create major inefficiencies in markets and likely have a major impact on U.S. competitiveness. None of which, of course, are desirable.

Foreign jurisdictions are not requiring their banks. Here, we're talking about regulatory arbitrage. Sheila Bair has specifically asked that we recognize the damage that regulatory arbitrage has caused our economy and craft policies that focus on the quality and strength of regulation as opposed to the business model used to support it.

So we are dealing with foreign jurisdictions not requiring banks to push out swap activities, which places our institution at a competitive disadvantage in this regulatory arbitrage.

And I'll make note of the fact that swap activities in banks are still subject to the Volcker rule, which is, of course, as we all know under construction, prohibiting proprietary trading. And they are also subject to the enhanced requirements of Dodd-Frank for derivatives, specifically clearing and although not limited to clearing and margin requirements.

And for all of these reasons, I ask that the committee support H.R. 1838. Again, I will be introducing an amendment subsequently.

And, Mr. Chairman, I yield back, but thanks.

GARRETT: And I thank you as well. And the gentlelady yields back.

And the gentlelady from California is now recognized for five minutes.

WATERS: Thank you very much.

First, I'd like to thank the gentlelady for the offer to work with our staffs to try and work through some of the issues that were identified. It seems that there was a proposal that was looked at by both sides, and that Congresswoman Hayworth was not able to embrace any of the suggested tweaks in that proposal. And so we were not able to reach an accord.

We simply wanted you to know that we tried. We were appreciative for your attempts to do that. So therefore, I must oppose the bill the repeal Section 716 of the Dodd-Frank Act.

As you know, 716 of the act was a Senate provision added during the conference committee, which will require that banks push out a portion of swaps from the part of their businesses that has access to federal assistance, which includes the FDIC insurance an access to the Federal Reserve discount window.

Every credible account of the 2008 financial meltdown has found that over-the-counter derivatives played a key role in magnifying the length and severity of the crisis. Swaps related to mortgage-backed securities resulted in huge losses to investment and insurance firms like Lehman Brothers, Bear Sterns, and AIG.

Banks' exposure to the institutions that created these swaps is what made the 2008 crisis a systemic event and require taxpayers to step in and stabilize the entire financial system. The purpose of Section 716 was to try and reign in the speculative trading and return banks to their traditional functions of taking deposits and making loans for mortgages, small businesses, and other enterprises, and to minimize the activities that require the taxpayer-funded bailout.

Now I recognize that some industry's stakeholders have raised concerns about 716, for example.

At the hearing we had a few weeks ago, one of the witnesses raised legitimate issues about the differential treatment of domestically based banks versus foreign banks with a presence in the United States. Others have said that verification of swaps into different entities will make risk management more difficult.

But even with some issues yet to be resolved, I do not think that outright repeal of Section 716 is the appropriate action. Significant concessions to industry were already made during the Dodd-Frank conference committee.

For example, Section 716 doesn't go into effect until July 2013, and banks have an additional two years after that to divest their swaps. Moreover, national bank permissible swaps in Section 716 represent over 90 percent of the swaps market according to the OCC, meaning that we're talking about a small universe of activities that must be pushed out.

Finally, when we talk about Section 716, we're also only talking about a very select group of financial institu-

tions. Derivatives activity and the U.S. banking system continues to be dominated by a small group of large financial institutions with five large commercial banks representing 96 percent of the total banking industry notional amount.

Again, I would urge my colleagues to oppose repeal of Section 716, and I yield back the balance of my time.

GARRETT: The gentlelady yields back.

The gentlelady from New York, did you indicate that you had an amendment?

HAYWORTH: Yes, Mr. Chairman. I do have an amendment at the desk.

GARRETT: An amendment at the desk, the clerk will report that amendment.

(UNKNOWN): Amendment offered by Ms. Hayworth, Page 1, strike Line 3 and insert the following, Section 1 Short Title.

This act may be cited as the Swaps Bailout Prevention Act.

Section 2 repeal, Page 1 beginning on Line 3, strike repealed and insert amended by striking subsections A through H and J through M and redesignate...

GARRETT: Thank you, clerk.

Unanimously consented, considered as read.

And the gentlelady is recognized.

HAYWORTH: Thank you, Mr. Chairman.

In introducing this amendment actually in response with all due respect to the gentlelady from California is at least a portion of her concerns because we have indeed been endeavoring the we're together in good faith. There has been support for or broad criticism, I should say, of 716 which certainly crosses party lines and political philosophies.

The specific concern addressed in this amendment is the bailout potential. And although this is -- this essentially takes a belt-and- suspenders approach to make sure that we have reassured everyone who might have concerns that even though they -- they are addressing other sections of Dodd-Frank that we are also addressing them specifically in this piece of legislation.

So this amendment, as you can see from the text retains the prohibition on bailouts in the existing subsection I of Section 716, and it prevents bailouts in three ways.

First, it prohibits the use -- expressly prohibits the use of taxpayer funds to avoid receivership due to swaps activities.

Second, it requires the repayment of taxpayers for all expenses incurred in winding down swaps activities in failed institutions.

And finally again, it serves as, if you will, a redundancy of belt-and-suspenders approach to expressly state the taxpayers bearing a loss for swaps activities.

We are absolutely sincere -- I am sincere about building a consensus across parties. And I ask you to support of this amendment and then of the bill as amendment. And I yield back at this time.

Thank you, Chairman.

(UNKNOWN): Mr. Chairman?

(CROSSTALK)

WATERS: We'll strike the last words.

GARRETT: The gentlelady is recognized.

WATERS: This amendment would preserve subsection I of Section 716 of the Dodd-Frank Act and strike the rest of the section.

Subsection I provides that no taxpayer funds can be used to prevent the receivership of any swap entity resulting from swaps activity. This applies for FDIC-insured institutions -- institutions that pose a systemic risk to the economy and non-FDIC-insured, nonsystemically significant institutions.

Now, I appreciate the gentlewoman from New York's attempt to work with me on this provision, but I'm afraid this amendment fell short. The substantive part of Section 716 is a requirement that institutions with access to federal assistance push out their swaps business. This amendment does nothing to ensure that entities will be required to engage in this push-out.

Language saying that there can be no bailout of these institutions is meaningless if we don't stop the activity that

could lead to such a bailout. I understand that Citigroup and others have proposed some language to tweak parts of Section 716 to deal with specific problems such as disparate treatment of foreign and domestic banks.

The underlying bill and this amendment do not seek to take a nuance approach to correct technical mistakes, instead H.R. 1838 is still an outright repeal of Section 716. This amendment would make it such that entities engaging in risky swaps could still get bailed out. The language would just make it such that the taxpayer would be able to recover funds after they were expended. This is exactly what happened in TARP.

Section 716 was already significantly changed during the conference committee to respond to industry concerns. The section permits national banks to keep market-making desk and interest rate swaps, foreign exchange swaps, clear credit default swaps, referencing investment-grade names, and swaps on gold, silver, copper, platinum, and palladium.

National bank permissible swaps in Section 716 already represent over 90 percent of the swaps. Again, the swaps market, according to the Office of the Comptroller of Currency, derivatives activity in the U.S. banking system again continues to be dominated by a small group of large financial institutions with the five large commercial banks representing 96 percent of the total banking industry notional amount and 86 percent of industry net current credit exposure, according to OCC.

This provision doesn't take effect until July 2013, and banks have another two years after that to spin off these swaps. This is plenty of time to adjust to this new regulation. So I yield back the balance of my time.

GARRETT: The gentlelady yields back, and I'll recognize myself, and then I'll recognize the gentlelady from New York.

Just to say this, I appreciate the fact that the gentlelady from California says -- pointed out initially that this underlying legislation 716 was added through the Senate, through the conference. I agree with that.

I somewhat disagree with the caricature of the ability for consideration of all the other parties to this during the conference. I was on that conference. This amendment was added literally at the last minute, in the wee hours of the morning. We did not have the opportunity -- well, we did not have the opportunity to have a full discussion here, obviously, in this committee as we would have liked to have had.

We did not have an opportunity to have a full discussion. And as the gentlelady from California says, hearing from the respective parties in the conference because, as you know, the conference doesn't have that, and as I said, it was just done literally at the last minute. So this is really a case of -- for the first time for this full committee -- both sides of the aisle -- to have an open and honest airing in discussion of the issues. And it is a complicated issue but this is what we're all about to be able to have that discussion.

And so having been there at the committee and having worn through day after day after day, realizing we were pushing through a lot of legislation, this was done at the very last minute. And I think it's appropriate now we have this opportunity to discuss it and perhaps make some -- take into the consideration the points that the gentlelady raises were not

considered at the conference committee.

With that, I yield back the...

WATERS: Would the gentleman yield?

MALONEY: I would...

GARRETT: The gentlelady from New York.

WATERS: Yeah.

GARRETT: I'll recognize the gentlelady from New York. OK. I might as well just give you your own time and...

MALONEY: I -- I -- I would like more time to work on this.

As we all know, when we -- we sent Dodd-Frank to the Senate when we went into the conference committee, we thought that it was tough and that there would be no taxpayer bailout. And actually, this was called during that night the Lincoln amendment where she felt like she needed this extra deal going on.

I -- I -- I would like an opportunity to talk to Volcker about it. Apparently, he has come out in favor of the Hayworth amendment. And also, Zandi, a very respected economist on both sides of the aisle, has also come out for it.

And I -- I -- I think that we have to be careful to protect consumers, protect investors, protect the safety and soundness of our institutions but at the same time, not hamper them in a way that we are putting extra burdens on them that other competitors don't have. So I would respectfully like to ask my dear friend and colleague from the other side of the aisle from the great state of New York if she would not move forward at this point, but have a meeting with like-minded people where we could have Mr. Volcker there and maybe other stakeholders and have a discussion on this.

As the chairman pointed out -- Mr. Garrett -- 716 was -- was literally thrown in -- I think it was four o'clock in the morning when half of us were asleep. And I think that -- I think this is an important issue. And -- and there might be a better compromise. There may be other ways to look at going forward that answers the -- the concerns of the distinguished ranking members put forward.

And I -- I think that this is an important amendment. I think it has -- I think it should go forward in some form. I'm not so sure that it's this one, so that I just ask more time to work on it.

GARRETT: The gentlelady from New York?

HAYWORTH: Well, Mr. Chairman, in -- in order to serve the goal of facilitating as the gentlelady -- my esteemed colleague from New York has said, we want to facilitate appropriate credential regulation without impeding the best interest of all concerned in a vibrant marketplace, particularly, in a marketplace that has to compete globally.

I am certainly willing to -- to go that extra step if it will mean that we will get the kind of progress that -- that we need to make so.

GARRETT: To withdraw your amendment? I'm sorry.

HAYWORTH: Well, I -- I would like to keep -- certainly, I'd like to keep the amendment in place. And I would also...

GARRETT: OK.

HAYWORTH: ...make the following points simply that I do -- I do feel that the 1838 as amended, although I would support 1838 as -- as, you know, in its unamended form but as amended with the proposed amendment. It does achieve the -- the goal of having broad support given the documents.

And if I may, Mr. Chairman, I hope I'm not...

GARRETT: Without objection in the record.

HAYWORTH: ...my filing procedure, yes, to ask unanimous consent that several letters be placed into the record for today's hearing, including Mark Zandi's letter dated November 24, 2011, which supports repeal of Section 716, as well as documents from the International -- bankers, ISDA -- International Swaps and Derivatives Association -- financial services roundtable, all from the same date, and letters from Bair, Volcker, and Bernanke -- various chairmen from 2010.

So if I may, I'd like...

GARRETT: Without objection, they will all be entered into record.

HAYWORTH: Thank you. Thank you, sir.

But, you know, certainly I do -- I do want to allow everyone to feel heard, so I would prefer not to withdraw this...

GARRETT: OK.

HAYWORTH: ...this bill from consideration. But I would certainly appreciate the chairman's thoughts...

GARRETT: Well, your desire...

HAYWORTH: ...as to...

GARRETT: ...I was leaning back there when you said it...

HAYWORTH: ...what we'd like to do.

GARRETT: ...if I -- I'm not -- I'm not putting words into your mouth. So your desire is to move with you on the amendment?

HAYWORTH: I'd like to -- yes, I would like to move on this amendment.

GARRETT: OK. Let me give that prerogative.

HAYWORTH: Yeah.

GARRETT: And -- but, I guess, what you're saying when I was leaning back was you -- you're committed to try to work our some of those points.

HAYWORTH: Precisely.

GARRETT: And I will add that there are -- there is a point that I also may want to address as well.

HAYWORTH: Yes, sir, of which I am aware.

GARRETT: OK.

HAYWORTH: So perhaps between now and -- and...

GARRETT: The full committee.

HAYWORTH: ...the full committee, we can...

GARRETT: And...

HAYWORTH: Right.

GARRETT: ...try to get that done...

HAYWORTH: We can get that accomplished.

GARRETT: ...if it's -- I mean, you know, I may just not agree, well, you're the sponsor, we'll lean on with it but that's fine too.

HAYWORTH: With all respect, sir. Thank you.

GARRETT: Absolutely.

Any other discussion on the amendment? No. Then the question is on the amendment. All those in favor of the amendment...

HAYWORTH: Aye.

GARRETT: ...will say "aye." All those opposed of the amendment...

(UNKNOWN): No.

GARRETT: No. Question -- and the question, are there any other amendments? No.

The question now is on the bill as amended. All those in favor will say "aye."

GROUP: Aye.

GARRETT: Aye. All those opposed will say "nay."

WATERS: Nay.

GARRETT: A recorded vote is requested.

WATERS: Yes, it is.

GARRETT: Yes, and that recorded vote has been so noted and will be postponed until sometime when we figure out. So I thank the gentlelady, and we'll look forward to trying that, get the point that I have and the point the gentlelady has as well on that to see how that works happy for him. Thanks a lot.

END

---- INDEX REFERENCES ----

COMPANY: LEHMAN BROTHERS HOLDINGS INC; AMERICAN INTERNATIONAL GROUP INC; CITIGROUP INC; MOODYS CORP

NEWS SUBJECT: (Regulatory Affairs (1RE51); Mortgage-Backed Markets (1MO87); Legislation (1LE97); Monetary Policy (1MO18); Economics & Trade (1EC26); Funding Instruments (1FU41); Economic Policy & Policymakers (1EC69); Securitization (1SE75); Government (1GO80); Real Estate Investments (1RE04); Consumer Protection (1CO43))

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