113TH CONGRESS 1st Session } HOUSE OF REPRESENTATIVES { REPT. 113–229 Part 2

SWAPS REGULATORY IMPROVEMENT ACT

SEPTEMBER 25, 2013.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. LUCAS, from the Committee on Agriculture, submitted the following

REPORT

[To accompany H.R. 992]

[Including cost estimate of the Congressional Budget Office]

The Committee on Agriculture, to whom was referred the bill (H.R. 992) to amend provisions in section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to Federal assistance for swaps entities, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

BRIEF EXPLANATION

H.R. 992 limits the application of Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111–203) (Dodd-Frank Act) so that it does not apply to equity or commodity swaps traded by a financial institution. However, the section would continue to apply to certain structured finance swaps that are based on an asset-backed security and force those particular swaps to be traded in a separately capitalized entity outside of the banking entity.

PURPOSE AND NEED

During the late stages of the Senate's consideration of its financial reform bill in May of 2010 (prior to the Dodd-Frank Act Conference Committee debates), Senator Blanche Lincoln successfully added an amendment to prohibit "federal assistance" to any "swaps entity." That same provision would later become Section 716 of the Dodd-Frank Act. Under the Act, "federal assistance" is defined to include access to the Federal Reserve's discount lending window or Federal Deposit Insurance Corporation (FDIC) insurance or guar-

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antees, while "swaps entity" includes swap dealers, major swap participants, securities and futures exchanges, swap-execution facilities, and clearing organizations. In effect, Section 716 requires most major domestic and foreign banks doing business in the United States to push certain swaps activity outside of the bank into a separately capitalized affiliate. Therefore, Section 716 of the Dodd-Frank Act is colloquially referred to as the "swaps desk push-out" provision.

Section 716 does not cover all swaps. In fact, the provision allows financial institutions to continue dealing in swaps related to interest rates, foreign currency, and swaps permitted under the National Bank Act. However, banks are prohibited from engaging in swaps related to agricultural and non-agricultural commodities, equities, and credit. Banks would not be required to "push out" swaps used for hedging risks associated with their banking activities, and they would not be required to push out interest rate swaps, foreign currency swaps, credit default swaps (CDS) on investment grade names that are centrally cleared, or precious metal swaps. The prohibition is limited to equity derivatives, non-investment grade CDS and commodity swaps.

While Section 716 was supposedly intended to prevent certain swaps activities of banks from being eligible for a federal "bailout" via FDIC insurance or capital infusions from the Federal Reserve, opponents argue that Section 716 may actually make the U.S. financial system less stable. As Federal Reserve Board Chairman Ben Bernanke pointed out in 2009 during the Dodd-Frank debates, Section 716 "would make the U.S. financial system less resilient and more susceptible to systemic risk" because "forcing [commercial and hedging activities] out of insured depository institutions would weaken both financial stability and strong prudential regulation." [1]

Second, Section 716 may place U.S. financial institutions at a significant competitive disadvantage against their foreign counterparts because non-U.S. jurisdictions do not plan to adopt a provision similar to Section 716. In light of potential consequences like these, former Federal Reserve Board Chairman Paul Volcker and former FDIC Chairman Sheila Bair expressed serious concerns about Section 716 during the Dodd-Frank Act conference committee's deliberations.[2] Moreover, Congress was not urged to adopt Section 716 as part of the Dodd-Frank Act by any of the regulators, the Treasury Department did not include Section 716 in its submission of draft derivatives legislative text to the Congress in 2009, and neither the SEC nor the CFTC provided Section 716 to the Congress during the House or Senate deliberations on the Dodd-Frank Act.

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[1] Letter from Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, to Senator Chris Dodd (May 12, 2010).

[2] Letter from Former Federal Reserve Board Chairman Paul Volcker to Senator Chris Dodd, May 6, 2010 ("The provision of derivatives by commercial banks to their customers in the usual course of banking relationship should not be prohibited."); Letter from former FDIC Chairman Sheila Bair to Senators Chris Dodd and Blanche Lincoln, April 30, 2010 ("[O]ne unintended Letter from Former Federal Reserve Board Chairman Paul Volcker to Senator Chris Dodd, May 6, 2010 ("The provision of derivatives by commercial banks to their customers in the usual course of banking relationship should not be prohibited."); Letter from former FDIC Chairman Sheila Bair to Senators Chris Dodd and Blanche Lincoln, April 30, 2010 ("[O]ne unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund.").

During the Financial Services Committee consideration of H.R. 1838 (which originally repealed Section 716) on February 16, 2012, bipartisan language was adopted to limit the application of Section 716 so that it would not apply to equity or commodity swaps.[3] However, the section would continue to apply to structured finance swaps that are based on an asset-backed security. Retaining coverage of structured finance swaps based on asset-backed securities was intended to address concerns surrounding the well-known derivatives activity of American International Group (AIG) based on mortgage-backed securities which directly contributed to the company's precipitous decline and Federal bailout in the fall of 2008. H.R. 992 in the 113th Congress is substantively identical to the language adopted in the Financial Services Committee in the 112th Congress.

After passage in House Financial Services, 18 Democrats on the Committee signed Minority views for the Committee Report, including then-Ranking Member Barney Frank and Representative Maxine Waters, which stated:

> "Questions have been raised about this provision [Section 716] by economists and regulators including FDIC's Sheila Bair, who are concerned that it might interfere with a bank's ability to use derivatives to diminish risk. Section 716 was not part of the original House-passed version of the financial reform law. During the Full Committee markup, Democrats worked with the Majority to amend H.R. 1838 to continue the prohibition of complex swaps employed by AIG with devastating effect. H.R. 1838, as amended, addresses the valid criticisms of Section 716 without weakening the financial reform law's important derivative safeguards or prohibitions on bank proprietary trading."[4]

On December 31, 2012, the Office of the Comptroller of the Currency (OCC) issued guidance for domestic banks that extended the application of Section 716 for two or possibly three years from the July 2013 implementation deadline that had been set by federal regulators.[5] Confusingly, this implementation extension by the OCC did not apply to some branches of foreign banks, which are regulated by the Federal Reserve or the OCC depending on if they are eligible for deposit insurance fund coverage.

On February 26, 2013, Federal Reserve Chairman Ben Bernanke testified before the Senate Committee on Banking, Housing, and Urban Affairs, and stated in response to a question from Senator Crapo about Dodd-Frank reforms that "Dodd-Frank is a very big, complicated piece of legislation that addresses many different issues. And I'm sure there are many aspects of it that could be improved in one way, or another . . . [c]larity on what Congress would like us to do about end users, for example. Another area, which is proving difficult is the push out provision for deriva-

[3] *See* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=279947

[4] Emphasis added. See Additional Views of the Minority, Committee Report for H.R. 1838, House Committee on Financial Services, May 11, 2012; available at http://financialservices.house.gov/uploadedfiles/hrpt-112-hr1838.pdf

[5] *See* http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-2.html

tives."[6] The next day, in testimony before the House Committee on Financial Services, Chairman Bernanke elaborated on the need for Section 716 reform, stating "[a]nd it's not evident why that [Section 716] 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."[7]

Due to numerous federal regulators and market participants voicing concerns about the inclusion of Section 716 in the Dodd-Frank Act since before it became law, H.R. 992 would limit the application of Section 716 so that it does not apply to equity or commodity swaps. However, the section would continue to apply to certain structured finance swaps that are based on an asset-backed security.

Section-by-Section

Section 1 is the short title of the bill.

Section 2 amends section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act strikes "insured depository institution" and replaces it with the term "covered depository institution" which is defined as an injured depository institution and a domestically located uninsured branch of a foreign bank.

Section 716(d) is rewritten to exempt from the prohibition on swaps trading hedging and other risk mitigation activity, equity swaps, commodity swaps, non-structured finance swap activities, and certain structured finance swap activities of a certain credit quality and type as determined by the prudential banking regulators.

Committee Consideration

I. Hearings

In the 113th Congress, the Full Committee held a hearing March 14, 2013, to examine legislative improvements to Title VII of the Dodd-Frank Act which included H.R. 992, the Swaps Regulatory Improvement Act. During the hearing, the Committee heard testimony from the Chairman of the U.S. Commodity Futures Trading Commission and six additional witnesses representing a broad spectrum of participants in the derivatives market. Included is testimony from the Honorable Kenneth E. Bentsen, Jr., Acting President and CEO, the Securities Industry and Financial Markets Association.

> "The Swap Push-Out Rule has been opposed by senior prudential regulators from the time it was first considered. Ben Bernanke, Chairman of the Federal Reserve, stated in a letter to Congress that 'forcing these activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities.' Sheila Bair, former FDIC Chairwoman, said that 'by concentrating the activity in an affiliate of the insured bank, we could end up with less and lower quality capital,

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[6] *See* http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=e758db33–806e-4e77-887a-9b7f7db159be

[7] *See* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=320548

less information and oversight for the FDIC, and potentially less support for the insured bank in a time of crisis' and added that "one unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund.

In addition to the increase in risk that would be caused by the Swaps Push-Out Rule, the limitations will significantly increase the cost to banks of providing customers with swap products as a result of the need to fragment related activities across different legal entities. As a result, U.S. corporate end users and farmers will face higher prices for the instruments they need to hedge the risks of the items they produce. Mark Zandi, Chief Economist at Moody's Analytics, stated in a letter to Congressman Garrett that 'Section 716 would create significant complications and counter the efforts to resolve [large financial] firms in an orderly manner.'"

—The Honorable Kenneth E. Bentsen, Jr., Acting President and CEO, the Securities Industry and Financial Markets Association.

II. BUSINESS MEETINGS

The Committee on Agriculture met, pursuant to notice, with a quorum present, on March 20, 2013, to consider H.R. 992, the Swaps Regulatory Improvement Act, and other pending business.

H.R. 992 was placed before the Committee for consideration. Without objection, a first reading of the bill was waived and it was open for amendment at any point.

Chairman Lucas, Mr. Peterson, Mr. David Scott and Mr. Hudson were recognized for statements, and Counsel was then recognized for a brief explanation of the bill.

There being no amendments, Mr. Conaway was recognized to offer a motion that the bill H.R. 992 be reported favorably to the House with recommendation that it do pass. Mr. Peterson requested a recorded vote, and the motion was subsequently approved by a vote of 31 yeas, 14 nays and 1 not voting. See Roll Call #1.

The Committee then continued with other pending business, and at the conclusion of the meeting, Chairman Lucas advised Members that pursuant to the rules of the House of Representatives Members had 2 calendar days to file any supplemental or minority views with the Committee.

Without objection, staff was given permission to make any necessary clerical, technical or conforming changes to reflect the intent of the Committee. Chairman Lucas thanked all the Members and adjourned the meeting.

COMMITTEE VOTES

In compliance with clause 3(b) of rule XIII of the House of Representatives, the Committee sets forth the record of the following roll call votes taken with respect to H.R. 992.

ROLL CALL #1

Summary: Motion to favorably report H.R. 992, the Swaps Regulatory Improvement Act, to the House with recommendation that it do pass.

Offered By: Representative K. Michael Conaway

Results: Passed by a recorded vote of 31 yeas, 14 nays, and 1 not voting.

YEAS

1. Mr. Lucas
2. Mr. Goodlatte
3. Mr. King
4. Mr. Neugebauer
5. Mr. Rogers
6. Mr. Conaway
7. Mr. Thompson
8. Mr. Gibbs
9. Mr. Austin Scott
10. Mr. Tipton
11. Mr. Crawford
12. Mrs. Roby
13. Mr. DesJarlais
14. Mr. Gibson
15. Mrs. Hartzler
16. Mr. Ribble
17. Mrs. Noem
18. Mr. Benishek
19. Mr. Denham
20. Mr. Fincher
21. Mr. LaMalfa
22. Mr. Hudson
23. Mr. Davis
24. Mr. Collins
25. Mr. Yoho
26. Mr. McIntyre
27. Mr. David Scott
28. Ms. Kuster
29. Mr. Gallego
30. Mr. Vargas
31. Mr. Maloney

NAYS

1. Mr. Peterson
2. Mr. Costa
3. Mr. Walz
4. Mr. Schrader
5. Mr. McGovern
6. Ms. DelBene
7. Mrs. Negrete McLeod
8. Mr. Vela
9. Ms. Lujan Grisham
10. Mr. Nolan
11. Mr. Enyart
12. Mrs. Bustos
13. Mr. Courtney
14. Mr. Garamendi

NOT VOTING

1. Ms. Fudge

Committee Oversight Findings

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee on Agriculture's oversight findings and recommendations are reflected in the body of this report.

Budget Act Compliance (Sections 308, 402, and 423)

The provisions of clause 3(c)(2) of rule XIII of the Rules of the House of Representatives and section 308(a)(1) of the Congressional Budget Act of 1974 (relating to estimates of new budget authority, new spending authority, new credit authority, or increased or decreased revenues or tax expenditures) are not considered applicable. The estimate and comparison required to be prepared by the Director of the Congressional Budget Office under clause 3(c)(3) of rule XIII of the Rules of the House of Representatives and sections 402 and 423 of the Congressional Budget Act of 1974 submitted to the Committee prior to the filing of this report are as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 5, 2013.

Hon. FRANK D. LUCAS,
Chairman, Committee on Agriculture,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 992, the Swaps Regulatory Improvement Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Daniel Hoople and Barbara Edwards.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

H.R. 992—Swaps Regulatory Improvement Act

H.R. 992 would allow certain financial firms to retain their financial portfolios containing swaps while remaining eligible for assistance from the Federal Reserve and Federal Deposit Insurance Corporation (FDIC). A swap is a contract between two parties to exchange payments based on the price of an underlying asset or change in interest, exchange, or other reference rate. Swaps can be used to hedge or mitigate certain risks associated with a firm's traditional activities, such as interest rate risk, or to speculate based on expected changes in prices and rates.

CBO estimates that enacting this legislation would not have a significant impact on the net cash flows of the Federal Reserve or the FDIC over the next 10 years. Enacting this legislation could affect direct spending and revenues; therefore, pay-as-you-go procedures apply. However, CBO estimates that any such effects would be insignificant for the next 10 years.

Under current law, federal assistance is not available to any swap dealer or major swap participant registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission. Federal assistance includes access to any Federal Reserve credit facility and discount window (with some exception) and FDIC deposit insurance and guarantees. This prohibition does not apply to a major swap participant that is an insured depository institution (IDI) or an IDI acting as a swaps dealer for hedging purposes or for swaps involving bank-permissible securities. (Such swaps include those that reference interest rates, currencies, government securities, and precious metals. Examples of non-permissible swaps include equity swaps, commodity and agriculture swaps, energy swaps, and metal swaps excluding gold and silver.) Under current law, IDIs that do not meet these exceptions must "push out" their swaps portfolio to a separately capitalized affiliate if the firm is part of a financial holding company, or cease these activities altogether.

Similar to the exemption currently granted to IDIs, H.R. 992 would allow uninsured U.S. branches or agencies of a foreign bank to engage in certain permissible swap activities and to push out others to an affiliate without jeopardizing access to federal assistance. In addition, the legislation would expand permissible swap activities to exclude only swaps based on asset-backed securities that are unregulated or not of a credit quality established by regulation.

Enacting this legislation could affect direct spending and revenues if a change in swaps activity affects the financial stability of an IDI or other entity with access to assistance from the Federal Reserve and the FDIC. Because current law only affects IDIs that are swaps dealers and a small percentage of swap contracts, CBO estimates that any changes to the net cash flows of either agency would be insignificant for the next 10 years.

H.R. 992 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

The CBO staff contacts for this estimate are Daniel Hoople and Barbara Edwards. The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

Performance Goals and Objectives

With respect to the requirement of clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the performance goals and objectives of this legislation are to limit the application of Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111–203) so that it does not apply to equity or commodity swaps traded by a financial institution, but does still apply to certain structured finance swaps based on an asset-backed security.

Committee Cost Estimate

Pursuant to clause 3(d)(2) of rule XIII of the Rules of the House of Representatives, the Committee report incorporates the cost estimate prepared by the Director of the Congressional Budget Office pursuant to sections 402 and 423 of the Congressional Budget Act of 1974.

Advisory Committee Statement

No advisory committee within the meaning of section 5(b) of the Federal Advisory Committee Act was created by this legislation.

Applicability to the Legislative Branch

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act (Public Law 104–1).

FEDERAL MANDATES STATEMENT

The Committee adopted as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act (Public Law 104–4).

EARMARK STATEMENT REQUIRED BY CLAUSE 9 OF RULE XXI OF THE RULES OF THE HOUSE OF REPRESENTATIVES

H.R. 992 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(e), 9(f), or 9(g) of rule XXI of the Rules of the House of Representatives.

DUPLICATION OF FEDERAL PROGRAMS

H.R. 992 does not establish or reauthorize a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or any related program identified in the most recent Catalog of Federal Domestic Assistance.

DISCLOSURE OF DIRECTED RULE MAKINGS

The Committee does not believe that the legislation directs an executive branch official to conduct any specific rule making proceedings within the meaning of 5 U.S.C. 551.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

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TITLE VII—WALL STREET TRANSPARENCY AND ACCOUNTABILITY

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Subtitle A—Regulation of Over-the-Counter Swaps Markets

PART I—REGULATORY AUTHORITY

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SEC. 716. PROHIBITION AGAINST FEDERAL GOVERNMENT BAILOUTS OF SWAPS ENTITIES.

(a) PROHIBITION ON FEDERAL ASSISTANCE.—Notwithstanding any other provision of law (including regulations), no Federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity.

(b) DEFINITIONS.—In this section:

(1) FEDERAL ASSISTANCE.—The term "Federal assistance" means the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility under section 13(3)(A) of the Federal Reserve Act, Federal Deposit Insurance Corporation insurance or guarantees for the purpose of—

(A) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity;

(B) purchasing the assets of any swaps entity;

(C) guaranteeing any loan or debt issuance of any swaps entity; or

(D) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

(2) SWAPS ENTITY.—

(A) IN GENERAL.—The term "swaps entity" means any swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, that is registered under—

(i) the Commodity Exchange Act (7 U.S.C. 1 et seq.); or

(ii) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(B) EXCLUSION.—The term "swaps entity" does not include any major swap participant or major security-based swap participant that is an ⟦insured depository institution⟧ *covered depository institution*.

(3) COVERED DEPOSITORY INSTITUTION.—The term "covered depository institution" means—

(A) an insured depository institution, as that term is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); and

(B) a United States uninsured branch or agency of a foreign bank.

(c) AFFILIATES OF ⟦INSURED⟧ *COVERED* DEPOSITORY INSTITUTIONS.—The prohibition on Federal assistance contained in subsection (a) does not apply to and shall not prevent ⟦an insured⟧ *a covered* depository institution from having or establishing an affiliate which is a swaps entity, as long as ⟦such insured⟧ *such covered* depository institution is part of a bank holding company, ⟦or savings and loan holding company⟧ *savings and loan holding company, or foreign banking organization (as such term is defined under Regulation K of the Board of Governors of the Federal Reserve System (12 C.F.R. 211.21(o)))*, that is supervised by the Federal Reserve and such swaps entity affiliate complies with sections 23A and 23B of the Federal Reserve Act and such other requirements as the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, and the Board of Governors of the Federal Reserve System, may determine to be necessary and appropriate.

[(d) ONLY BONA FIDE HEDGING AND TRADITIONAL BANK ACTIVITIES PERMITTED.—The prohibition in subsection (a) shall apply to any insured depository institution unless the insured depository institution limits its swap or security-based swap activities to:

[(1) Hedging and other similar risk mitigating activities directly related to the insured depository institution's activities.

[(2) Acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the paragraph designated as "Seventh." of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), other than as described in paragraph (3).

[(3) LIMITATION ON CREDIT DEFAULT SWAPS.—Acting as a swaps entity for credit default swaps, including swaps or security-based swaps referencing the credit risk of asset-backed securities as defined in section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) (as amended by this Act) shall not be considered a bank permissible activity for purposes of subsection (d)(2) unless such swaps or security-based swaps are cleared by a derivatives clearing organization (as such term is defined in section la of the Commodity Exchange Act (7 U.S.C. la)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act (15 U.S.C. 78c)) that is registered, or exempt from registration, as a derivatives clearing organization under the Commodity Exchange Act or as a clearing agency under the Securities Exchange Act, respectively.]

(d) ONLY BONA FIDE HEDGING AND TRADITIONAL BANK ACTIVITIES PERMITTED.—

(1) IN GENERAL.—The prohibition in subsection (a) shall not apply to any covered depository institution that limits its swap and security-based swap activities to the following:

(A) HEDGING AND OTHER SIMILAR RISK MITIGATION ACTIVITIES.—Hedging and other similar risk mitigating activities directly related to the covered depository institution's activities.

(B) NON-STRUCTURED FINANCE SWAP ACTIVITIES.—Acting as a swaps entity for swaps or security-based swaps other than a structured finance swap.

(C) CERTAIN STRUCTURED FINANCE SWAP ACTIVITIES.—Acting as a swaps entity for swaps or security-based swaps that are structured finance swaps, if—

(i) such structured finance swaps are undertaken for hedging or risk management purposes; or

(ii) each asset-backed security underlying such structured finance swaps is of a credit quality and of a type or category with respect to which the prudential regulators have jointly adopted rules authorizing swap or security-based swap activity by covered depository institutions.

(2) DEFINITIONS.—For purposes of this subsection:

(A) STRUCTURED FINANCE SWAP.—The term "structured finance swap" means a swap or security-based swap based

on an asset-backed security (or group or index primarily comprised of asset-backed securities).

(B) ASSET-BACKED SECURITY.—The term "asset-backed security" has the meaning given such term under section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(e) EXISTING SWAPS AND SECURITY-BASED SWAPS.—The prohibition in subsection (a) shall only apply to swaps or security-based swaps entered into by [an insured] *a covered* depository institution after the end of the transition period described in subsection (f).

(f) TRANSITION PERIOD.—To the extent [an insured depository] *a covered depository* institution qualifies as a "swaps entity" and would be subject to the Federal assistance prohibition in subsection (a), the appropriate Federal banking agency, after consulting with and considering the views of the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, shall permit [the insured depository] *the covered depository* institution up to 24 months to divest the swaps entity or cease the activities that require registration as a swaps entity. In establishing the appropriate transition period to effect such divestiture or cessation of activities, which may include making the swaps entity an affiliate of [the insured depository] *the covered depository* institution, the appropriate Federal banking agency shall take into account and make written findings regarding the potential impact of such divestiture or cessation of activities on [the insured depository] *the covered depository* institution's (1) mortgage lending, (2) small business lending, (3) job creation, and (4) capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The appropriate Federal banking agency may consider such other factors as may be appropriate. The appropriate Federal banking agency may place such conditions on [the insured depository] *the covered depository* institution's divestiture or ceasing of activities of the swaps entity as it deems necessary and appropriate. The transition period under this subsection may be extended by the appropriate Federal banking agency, after consultation with the Commodity Futures Trading Commission and the Securities and Exchange Commission, for a period of up to 1 additional year.

(g) EXCLUDED ENTITIES.—For purposes of this section, the term "swaps entity" shall not include any insured depository institution under the Federal Deposit Insurance Act or a covered financial company under title II which is in a conservatorship, receivership, or a bridge bank operated by the Federal Deposit Insurance Corporation.

(h) EFFECTIVE DATE.—The prohibition in subsection (a) shall be effective 2 years following the date on which this Act is effective.

(i) LIQUIDATION REQUIRED.—

(1) IN GENERAL.—

(A) FDIC INSURED INSTITUTIONS.—All swaps entities that are FDIC insured institutions that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. 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.

(B) INSTITUTIONS THAT POSE A SYSTEMIC RISK AND ARE SUBJECT TO HEIGHTENED PRUDENTIAL SUPERVISION AS REGULATED UNDER SECTION 113.—All swaps entities that are institutions that pose a systemic risk and are subject to heightened prudential supervision as regulated under section 113, that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. 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.

(C) NON-FDIC INSURED, NON-SYSTEMICALLY SIGNIFICANT INSTITUTIONS NOT SUBJECT TO HEIGHTENED PRUDENTIAL SUPERVISION AS REGULATED UNDER SECTION 113.—No taxpayer resources shall be used for the orderly liquidation of any swaps entities that are non-FDIC insured, non-systemically significant institutions not subject to heightened prudential supervision as regulated under section 113.

(2) RECOVERY OF FUNDS.—All funds expended on the termination or transfer of the swap or security-based swap activity of the swaps entity shall be recovered in accordance with applicable law from the disposition of assets of such swap entity or through assessments, including on the financial sector as provided under applicable law.

(3) NO LOSSES TO TAXPAYERS.—Taxpayers shall bear no losses from the exercise of any authority under this title.

(j) PROHIBITION ON UNREGULATED COMBINATION OF SWAPS ENTITIES AND BANKING.—At no time following adoption of the rules in subsection (k) may a bank or bank holding company be permitted to be or become a swap entity unless it conducts its swap or security-based swap activity in compliance with such minimum standards set by its prudential regulator as are reasonably calculated to permit the swaps entity to conduct its swap or security-based swap activities in a safe and sound manner and mitigate systemic risk.

(k) RULES.—In prescribing rules, the prudential regulator for a swaps entity shall consider the following factors:

(1) The expertise and managerial strength of the swaps entity, including systems for effective oversight.

(2) The financial strength of the swaps entity.

(3) Systems for identifying, measuring and controlling risks arising from the swaps entity's operations.

(4) Systems for identifying, measuring and controlling the swaps entity's participation in existing markets.

(5) Systems for controlling the swaps entity's participation or entry into in new markets and products.

(l) AUTHORITY OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL.—The Financial Stability Oversight Council may determine that, when other provisions established by this Act are insufficient to effectively mitigate systemic risk and protect taxpayers, that swaps entities may no longer access Federal assistance with respect to any swap, security-based swap, or other activity of the swaps entity. Any such determination by the Financial Stability Oversight Council of a prohibition of federal assistance shall be made on an institution-by-institution basis, and shall require the vote of not fewer than two-thirds of the members of the Financial Stability Oversight Council, which must include the vote by the Chairman of the Council, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairperson of the Federal Deposit Insurance Corporation. Notice and hearing requirements for such determinations shall be consistent with the standards provided in title I.

(m) BAN ON PROPRIETARY TRADING IN DERIVATIVES.—An insured depository institution shall comply with the prohibition on proprietary trading in derivatives as required by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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