



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 2, 2013

Ms. Esta E. Stecher
Goldman Sachs Bank USA
200 West Street
New York, New York 10282

Subject: Request for a transition period under section 716(f) of the Dodd-Frank Act

Dear Ms. Stecher:

This responds to the request filed by Goldman Sachs Bank USA (“GS Bank”) for a transition period under section 716(f) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). GS Bank is a New York state-chartered member bank that provisionally registered as a swap dealer with the Commodity Futures Trading Commission (the “CFTC”) on December 31, 2012.

Section 716 of the Dodd-Frank Act generally prohibits the provision of “Federal assistance” to any swaps entity, subject to certain exceptions for insured depository institutions.¹ A swaps entity generally includes any swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant that is registered under the Commodity Exchange Act or the Securities Exchange Act of 1934, as applicable, with certain exceptions.²

Section 716(f) provides that the appropriate Federal banking agency “shall permit” an insured depository institution that qualifies as a swaps entity a transition period of up to 24 months to comply with the provisions of section 716. The Board of Governors of the Federal Reserve System (the “Board”) is the appropriate Federal banking agency for GS Bank.³ Section 716(f) requires the Board to consult with and consider the views of the CFTC and the Securities and Exchange Commission (the “SEC”), as appropriate, when determining an appropriate transition period.⁴

¹ See 15 U.S.C. § 8305(a). “Federal assistance” is defined in section 716(b)(1) as “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. ...” 15 U.S.C. § 8305(b)(1).

² See 15 U.S.C. § 8305(b)(2).

³ See 12 U.S.C. § 1813(q)(2).

⁴ Board staff consulted with the CFTC and the SEC. Neither agency offered comment on the request.

Background

Section 716 is contained in Title VII of the Dodd-Frank Act, which establishes a comprehensive new regulatory framework for swaps, security-based swaps, and the markets for such instruments. An orderly restructuring of swaps-dealing activities as a result of the application of section 716 is related to and affected by regulatory actions to implement Title VII. Development of the regulatory structure under Title VII is ongoing. The CFTC and the SEC, which have primary regulatory authority for Title VII, are actively issuing proposed and final rules, as well as guidance and exemptive orders, to implement Title VII. Although the Title VII regulatory structure is still being implemented, section 716 goes into effect on July 16, 2013.⁵

In granting a transition period under section 716(f), the Board is required by statute to take into account and make written findings regarding the potential impact of divestiture or cessation of swaps-dealing activities on the insured depository institution's (1) mortgage lending, (2) small business lending, (3) job creation, and (4) capital formation versus the potential negative impact on (1) insured depositors and (2) the Deposit Insurance Fund ("DIF") of the Federal Deposit Insurance Corporation (the "Statutory Factors").⁶ The Board may also consider other factors as may be appropriate.⁷ The Board has delegated authority to the Director of the Division of Banking Supervision and Regulation ("Director") or his or her designee, in consultation with the General Counsel, to establish a transition period of up to 24 months for institutions requesting transition-period relief.

Consideration of the Statutory Factors and Findings

In establishing the appropriate transition period to effect divestiture or cessation of swaps-dealing activities, the Director has considered the Statutory Factors as well as the extent to which the length of the transition period would affect the potential for operational risk problems and other risks associated with restructuring swaps activities. In its request for transition-period relief, GS Bank represented that it would be required to divest or cease a portion of its current swaps activities in order to limit the swaps activities to those that would be permissible under section 716(d) of the Dodd-Frank Act after the expiration of the transition period.

Mortgage Lending.

Near-term cessation or divestiture of GS Bank's swaps activities may increase operational risk problems. Operational problems in swaps markets could easily disrupt broad financial markets since swaps are widely used by corporations, institutional investors, and other financial market participants. A disruption to broad financial markets could indirectly disrupt mortgage-lending markets. For instance, an insured depository institution that is novating

⁵ See Guidance on the Effective Date of Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 77 Federal Register 27456 (May 10, 2012).

⁶ 15 U.S.C. § 8305(f).

⁷ Id.

derivatives contracts or ceasing derivatives activities may experience operational problems and be subject to reputation risk. These risks could negatively affect the insured depository institution's ability to access capital markets or hedge its own risk. In turn, this could lead to a slowdown in the insured depository institution's own mortgage market activity and potential delays to mortgage applicants.

Divestiture or cessation of GS Bank's swaps activities in the short run may also pose challenges to the bank's clients who are active in the mortgage market as investors, servicers, and originators to the extent that it could complicate the routine implementation of risk-management strategies. As a consequence, counterparties could more quickly run up against their limits on counterparty exposure to GS Bank and its affiliates, which would likely raise the cost of mortgage lending or lead to a reduction in the amount of mortgage lending.

A 24-month transition period could significantly mitigate operational risk and reputation risk by providing reasonable time for GS Bank to develop and implement an orderly transition plan. Lower operational risk, in turn, decreases the probability that cessation of GS Bank's swaps activities would adversely affect mortgage lending.

Small Business Lending.

Consistent with the effects on mortgage lending, near-term cessation or divestiture of GS Bank's swaps may pose operational risks and reputation risks that affect small business lending by GS Bank. Operational problems in the swaps market in general could also have a negative effect on small business lending.

A 24-month transition period could mitigate these risks and, therefore, mitigate the risk of a financial market disruption that could impair small business lending. Lower risk, in turn, could decrease the probability of a financial market disruption that could adversely affect small business lending.

Job Creation.

In evaluating the effects of divestiture or cessation of swaps dealing on job creation, the Director has considered the direct relationship between immediate cessation of derivatives activities and the loss of revenues and jobs.

The near-term cessation or divestiture of GS Bank's swaps dealings has the potential to result in job losses throughout the broader economy if the bank reduced its lending and financial intermediation activities.

A 24-month transition period could mitigate the potential for general market disruptions, including disruptions to credit and capital markets that could weaken job growth and have other negative macroeconomic consequences.

Capital Formation.

In evaluating the effects of divestiture or cessation of swaps dealing on capital formation at GS Bank, the Director has considered, among other things, lending activities, the loss of netting efficiencies, and costs associated with the modification of business practices and compliance procedures.

Negative impacts on lending described above may have a negative effect on U.S. economic growth and capital formation from counterparties, especially in the short term if counterparties are forced to replace swaps at GS Bank with swaps with other counterparties. Loss of netting efficiencies and modifications to business practices and compliance procedures may also negatively affect capital formation and cause a disruption in capital markets. The potential hazard of a disruption in capital markets may be more immediate than in other markets because capital markets may react quickly to operational problems. This would be especially true for a financial institution that encounters any serious operational problems from section 716-related restructuring because of the relationship between derivatives activities and capital markets activities.

A 24-month transition period could mitigate the potential of capital market disruptions. Thus, by granting a sufficient transition period, risks to individual financial institutions and to the banking system as a whole would be decreased. The benefit of mitigating the risk of capital market disruption favors granting a 24-month transition period to GS Bank.

Other Factors.

As permitted by section 716, the Director has also considered other potential effects of requiring immediate conformance with section 716. Compliance with section 716 will require an insured depository institution, such as GS Bank, to (1) determine whether to terminate its swaps activities or transfer them to a third party or an affiliate; (2) identify and capitalize an affiliate, if appropriate, to accept the swaps; and (3) novate existing swaps to the affiliate. Terminating or novating existing swaps will require the parties to negotiate and enter into new or modified swap arrangements, which could change the parties' exposure with respect to the swaps. New agreements or modifications to existing agreements may require the parties to adjust related transactions, including existing hedges. If an insured depository institution were required to divest or cease these swaps activities in a short time period, it may lead to a disorderly and inefficient unwinding that could present operational and risk-management risks for both the insured depository institution and its counterparties. These modifications could be complicated by the fact that they would occur simultaneously with many regulatory and structural market changes.

Insured Depositors.

Insured depositors are protected from risk of loss during the transition period up to the current standard maximum deposit insurance amount of \$250,000. The Director has concluded that a 24-month transition period would be less likely to negatively affect insured depositors than a shorter transition period because an orderly restructuring of GS Bank's swaps dealing over that

period of time would be less likely to have a negative effect on the financial health of GS Bank than would the quick cessation of swaps activities.

Moreover, GS Bank is subject to regulatory and other requirements designed to require the bank to conduct its swaps activities in a safe and sound manner. GS Bank would remain subject to examination to verify its conformance with those requirements. The regulatory framework mitigates the risk from conduct of affected derivatives activities during the transition period.

The Deposit Insurance Fund (DIF).

The DIF bears the risks associated with resolving an insured depository institution that has failed because of problems related to its swaps dealing. This risk includes payouts from the DIF to insured depositors of the institution. The Director has decided that it is also necessary to consider the risks to the DIF that could result from potential market disruptions under a scenario with an inadequate transition period.

For the reasons explained above, an orderly restructuring of GS Bank's swaps dealing poses less risk to the DIF than if the bank were required to cease or divest its swaps dealing without a sufficient transition period. Although swaps dealing does have inherent risks, the operational, reputational, and other risks to GS Bank of a requirement for an immediate cessation or divestiture, as discussed above, are more likely to cause market disruptions that threaten the DIF. Moreover, as noted above, GS Bank is required to conduct affected derivatives activities in a safe and sound manner during the transition period. On balance, the Director has concluded that avoiding potential market disruptions and the negative effects they could have on the DIF support a 24-month transition period for GS Bank.

Conclusion

As set out above, the Director has evaluated the impact of divestiture or cessation of GS Bank's swaps dealing on mortgage lending, small business lending, job creation, and capital formation versus the potential negative impact on insured depositors and the DIF in determining the appropriate length of the transition period. Overall, the Director has determined that the potential impact of granting a 24-month transition period is less adverse than the potential impact of denying the transition period or providing a significantly shorter transition period. The lesser impact associated with a 24-month transition period results from lowering the probability of operational problems and market disruption that could occur if GS Bank does not have a sufficient opportunity to restructure its swaps dealing in an orderly manner.

The 24-month transition period would permit GS Bank to better evaluate whether to transfer the swaps activities to a third party or an affiliate(s) and which affiliate(s) is best positioned to accept its swaps business. The 24-month transition period also would permit the creation of a new affiliate(s) and appropriate capital planning for any affiliate that assumes swaps activities. This transition period would also allow GS Bank to evaluate its decisions in the context of further development of the regulatory requirements of Title VII.

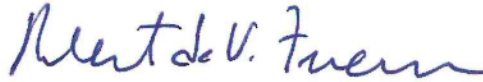
In contrast, a significantly shorter or no transition period could result in disorderly termination or divestiture of swaps activities and considerable disruption to swaps markets and financial markets that could weaken lending markets and result in a similar negative impact on job creation and capital formation.

After considering the written findings set forth above, and after consulting with the CFTC and the SEC, the Director, in consultation with the General Counsel, acting pursuant to delegated authority, has determined to establish a 24-month transition period under section 716(f) for GS Bank beginning on July 16, 2013.

This approval is conditioned on the facts and representations set forth in GS Bank's correspondence. These representations are deemed to be conditions imposed in writing by the Board in connection with the findings and decision herein and, as such, may be enforced in proceedings under applicable law. Any change in the facts and representations presented could result in a different conclusion and should be reported to Board staff immediately.

If you have any questions concerning this letter, please contact, of the Board's Legal Division, Victoria Szybillo, Counsel, at (202) 475-6325, or Michelle Kidd, Attorney, at (202) 736-5554.

Sincerely yours,

A handwritten signature in blue ink that reads "Robert deV. Frierson". The signature is fluid and cursive, with the first name "Robert" being the most prominent.

Robert deV. Frierson
Secretary of the Board

cc: J. Virgil Mattingly, Esq.
Sullivan & Cromwell LLP