Title: It is widely understood in financial circles that the foreign subsidiary has a de facto guarantee backed by the LENDER of LAST RESORT to the bank holding company is the U.S. taxpayer!
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C. Deguaranteeing Does Not Eliminate Systemic Risk: U.S. Parent Banks and the U.S. Taxpayers Remain on the Hook

It is a long-standing practice of corporate governance that when a parent entity has created a subsidiary engaged in high-risk activities, the parent entity offers assurances to third party partners/customers in the form of a downstream guarantee of the subsidiary.[417] The deguarantee loophole changes decades of common practice. For example, in 1992, the then-budding swaps market relied heavily on the assurances of guarantees as evidenced by the standardized Credit Support Annex to the ISDA Master Agreement.[418]

Now, in what is a several hundred trillion-dollar notional value swaps market, guarantees of swaps trading subsidiaries are suddenly no longer deemed a business necessity. This is certainly so because 90% of the U.S. swaps market is handled by the four huge U.S. bank holding company swap dealers who, as the aftermath of the Great Recession shows, are generally understood to be backed by the U.S. government through U.S. taxpayer-funded bailouts.[419] Swaps counterparties to these huge U.S. bank holding company swaps dealers and their foreign affiliates know that these institutions are "too-big-to-fail," and thus an explicit guarantee from the parent is really no longer needed. As mentioned earlier, there is such certainty that these big banks will be rescued in a financial crisis that that understanding is embedded in the stock price of these banks.[420]

The ISDA deguarantee language is nothing more than a legal fiction. It does not in fact shield any parent U.S. bank holding company swaps dealer from the practical, real-world risk of

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[416] Levinson, *supra* note 351.

[417] *See generally* Casandra Jones Havard, *Back to the Parent: Holding Company Liability for Subsidiary Banks — A Discussion of the Net Worth Maintenance Agreement, the Source of Strength Doctrine, and the Prompt Corrective Action Provision*, 16 CARDOZO L. REV. 2353 (1995).

[418] *See* Credit Support Annex, *supra* note 412.

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[418] *See* Credit Support Annex, *supra* note 412.

[419] *See supra* note 33 and accompanying text.

[420] *Id.*

WTFF!! It is widely understood in Financial Circles that the Foreign Subsidary has a de facto guaruntee backed by the LENDER of LAST RESORT to the BANK HOLDING Company: the US TAX PAYER!

a foreign subsidiary default. Were a U.S. bank to allow the failure of their de-guaranteed foreign subsidiary, the creditworthiness of its many other deguaranteed or guaranteed affiliates and subsidiaries,[421] and even the parent U.S. bank itself, would immediately suffer severe reputational damage, and that damage would manifest itself with that bank quickly being deemed a credit risk.[422] Thus, even without a guarantee, it is widely understood in financial circles that the foreign subsidiary has a *de facto* guarantee backed by the lender of last resort to the bank holding company: the U.S. taxpayer.

The CFTC acknowledged this fact when it said in the July 2013 guidance: "[e]ven in the absence of an explicit business arrangement or guarantee, U.S. companies may for reputational or other reasons choose, *or feel compelled*, to assume the cost of risks incurred by deguaranteed foreign affiliates."[423] As one market expert so aptly put it: "The market knows and relies on the unstated fact that the U.S. parent bank can and ultimately must bail out any purportedly unguaranteed subsidiaries to avoid the reputational and run risk associated with their failure."[424] The real effect is that using the "deguarantee" to evade Dodd-Frank means that "banks are again